Canada. Royal commission on banking and finance.
Hearings, v. 12-13. Briefs, v. 11A-12A. 1962.

1964

Royal Commission on Banking and Finance

Hearings held at

TORONTO

Vol.

12

Date.

April 13, 1962

Official Reporters
F.J. Nethercut and R.J. Young
Toronto, Ont.

Toronto, Ontario,
Friday, April 13, 1962.

ROYAL COMMISSION ON
BANKING AND FINANCE

I N D E X

ROYAL COMMISSION ON BANKING

AND FINANCE

Hearings held at Toronto,
Ontario, on Friday
April 13th,1962.

THE COMMISSION

The Honourable Dana Harris Porter
Chief Justice of Ontario
Toronto, Ontario - Chairman

Mr. W. Thomas Brown, M.B.E.
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Vancouver, British Columbia

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Mr. Paul H. Leman
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Mr. John C. MacKeen
Corporation Executive
Halifax, Nova Scotia

Dr. W.A. Mackintosh
Vice-Chancellor
Queen's University
Kingston, Ontario

Mr. H.A. Hampson - Secretary

Mr. Gilles Mercure - Joint Secretary

Toronto, Ontario
Friday, 13th April, 1962.

THE CHAIRMAN: We will call the meeting to order. The first brief before us today is that of Gairdner & Company. Are you ready to proceed?

MR. KENNER: Yes we are.

SUBMISSION OF GAIRDNER & COMPANY LIMITED

APPEARANCES

Mr. A. Kenner	- Director and Institutional Sales Manager
Mr. W. Keyser	- Money Market Specialist

MR. KENNER: My name is Kenner. It is a pleasure to be able to present this brief to the Royal Commission. It is in two parts, the first part on the secondary market and N.H.A. mortgage and the second part is on the short-term capital market.

I will speak on the N.H.A. section and my associate, Mr. Keyser, our money market specialist, will speak on the capital market section. Then, after a brief outline of our submission we are both willing and able to answer any questions on either section.

THE CHAIRMAN: Then, will you proceed.

MR. KENNER: Yes.

The first section is on the N.H.A. mortgage market. Our proposal is that the offerings by C.M.H.C. be continued and increased and that C.M.H.C. would act in the same way in the mortgage market as the Bank of Canada does in the government market and that there be established banking arrangements to facilitate dealers who hold positions in N.H.A. mortgages and also streamline the administration and transfers.

These two sections will enable the large lenders who are not presently in the mortgage business to enter that field and that to enable the small investors to take a part in the financing of homes in the country that C.M.H.C. issue debentures in the same manner that the Federal National Mortgage Association in the States offers debentures in small denominations to the public. Then, this will tap not only the large pension funds and large investors but also the small investors.

At the present time in the field the Central Mortgage has sold a total of $60 million of mortgages. To date this has not spread the mortgage field very wide, that is, getting new investors into it. It is estimated that probably only five or six new investors who have never anything to do with mortgages have bought any of these yet. Most of them have been bought by people who were already in the mortgage business or who had some family relationship with an administrator or something along that line.

Another of the ideas that we hoped this brief would tend to improve is that it would make one mortgage market in the country instead of several. At the present time there is a variety of prices for your N.H.A. mortgages even though they are all government guaranteed. This is caused by difficulty of administration in some centres as opposed to others and also the procedure of disclosure varies from province to province.

So in order to improve this situation we think it would be desirable that the Bank Act be changed so that the chartered banks would be allowed to finance dealers' N.H.A. mortgage positions in a manner similar to the way they finance other government corporate bonds on call loans.

That briefly is our N.H.A. mortgage submission.

THE CHAIRMAN: Had we better deal with that before we proceed with the other part? We will deal with that before we go on to the second branch of your submission.

Questions?

COMMISSIONER GIBSON: Mr. Chairman, I might ask a couple of general questions. If you were to get a marketable instrument of the kind you are talking about, where would the funds that you would hope to gain access to come from? You mentioned the possibility of selling to pension funds, small investors. What would those people be providing now that might be -- what would they be investing

in now that they might leave and turn to mortgages? Do you see what I am getting at?

MR. KENNER: It is true, this does not create any new source of savings. It is just trying to improve what these pension funds can invest in at the present time. There are several varieties to the ones we have, these large pension funds of municipal and provincial employees etc. At the present time the acts governing the investments of these pension funds in most provinces are limited to exclude the N.H.A. mortgages. It is only in Saskatchewan and Nova Scotia where these large civil service pension funds have been allowed to enter this. So the spread of this would allow these people to gain a higher return on their pension fund and so improve their pension. To date in every variety of pension fund their investments have been bonds of both varieties and some stocks. So this would merely be a way of allowing them to increase the return on their investment.

COMMISSIONER GIBSON: Yes, but thinking of it from the government's point of view, is there any value in it? If the result were to make these much more marketable instruments or produce an instrument based on N.H.A. mortgages more marketable and if this meant that small investors who buy savings bonds or perhaps municipals or provincials were to buy these instead what would be the value of this from the government's point of view?

MR. KEYSER: If I may add to what Mr. Kenner

has said already I think it is expected that a more marketable mortgage instrument, whether it was in the form of specifically assigned mortgages themselves or in the form of debentures against mortgages, a more marketable type of instrument would probably attract additional amounts of capital from those who already invest in mortgages because they would no longer need to fear the risk of having to re-sell and, furthermore, I think possibly some corporate pension funds who may perhaps due to lack of knowledge of this type of investment have not been heretofore in them may be attracted by the re-saleability of mortgages as we conceive it in the brief.

COMMISSIONER GIBSON: But there is no reason to believe it would increase savings in general. It would give them another instrument compared with other instruments available now.

MR. KENNER: Only to the extent that a higher rate of interest would encourage people to save.

THE CHAIRMAN: I am not quite sure how you expressed it but you suggested that some action should be taken similar to that which the Bank of Canada takes with reference to securities and apply the same sort of procedure to your type of mortgage security.

MR. KENNER: Yes.

THE CHAIRMAN: Could you elaborate on that? I am not quite clear as to exactly what your

suggestion is.

MR. KENNER: The idea there is that the value of these mortgages to a great extent rests in the residual value of the guarantee by the government at the present time. This would tend to make one N.H.A. mortgage about equal to another one. This is not really so at the present time. Mortgages located in large metropolitan areas will pay a higher price than, say, mortgages in small outlying areas and one of the reasons for this is that on any mortgage you must administrate it and see that the payments are kept up and so on and there are more trust companies, banks, etc., able to do this in the larger centres than the small ones so it is more costly to administrate those in smaller areas so they are worth less.

Now, the idea was that there should be a change in the guarantee so that if foreclosure is slow now at the present time you lose money but change this so that the investor does not lose any money and these things would tend to make one mortgage the same as another mortgage. Also, the administration, that Central Mortgage can administer any mortgage and they would all be the same. And then one mortgage away up in the north of Edmonton or somewhere would be worth as much as one in Toronto and that when you have these mortgages one the same as the other if Central Mortgage act as the bank and had more or less a bid for mortgages and offerings again this would

be above and below the market and it would tend to establish a value for mortgages and would tend to make it easier for the middleman such as the investment dealer to carry out the job as the jobber in these mortgages again making it more marketable.

COMMISSIONER BROWN: If this instrument was created do you envisage what sort of differential yield would you receive between the C.M.H.C. piece of paper and C.N.R.'s for example?

MR. KENNER: You are speaking of the C.M.H.C. if they issued debentures?

COMMISSIONER BROWN: If this piece of paper is created which you are talking about which is a bond of some kind ----

MR. KENNER: Yes, we had envisaged this as to look after the investments of the small investor. The large ones would continue to buy straight mortgages but on those there is very little differential at all. A Canada bond in the long-term is selling at about 4.85 per cent and a C.N.R. about 5. per cent and this C.M.H.C. debenture would be almost about the samee as the C.N.R. bond.

COMMISSIONER BROWN: Then, why should not the C.M.H.C. just issue guaranteed debentures and have another piece of government paper?

MR. KENNER: If they did this, they own $1½ billion mortgages out of $4½ billion at the moment. This would provide the money for that

[illegible]

$1\frac{1}{2}$ billion but I think you would have about $3 billion mortgages owned by other large investors and the idea is to make those more marketable so that the large investors would buy the blocks of mortgages themselves. The big people would own the mortgages themselves and the C.M.H.C. debentures would be for the smaller people. The yield would be lower.

COMMISSIONER BROWN: Why should not the government then issue additional bonds and advance the money to the C.M.H.C.?

MR. KENNER: This could be done but this would separate it out so that there would be a more direct connection between what C.M.H.C. does. That is the way the C.N.R. finance their own obligations rather than the government doing it for them.

COMMISSIONER GIBSON: I have the same problem as Mr. Brown. It seems to me that the mortgages are different in their essence and nature. There is more work connected with mortgages than with other types of securities. Why make them into government paper? If you make them into government paper why don't you do what he suggests and have the government just borrow the money in the first place? There are costs involved in this and this is an additional cost for somebody. Under your scheme, I take it, the additional cost would fall on the government.

MR. KENNER: Well, this business of the

government issuing securities would only look after the part that they own which is just about a quarter of the total. There have been some suggestions that large private mortgage companies be established to buy these N.H.A. mortgages from C.M.H.C. and in turn issue debentures themselves to the public and we think it would be better for C.M.H.C. to do that rather than to go through some intermediary.

COMMISSIONER GIBSON: In this case, as I understand it, the proposal is that some private groups do this and bear the costs. In your proposal you are really saying that the C.M.H.C. or the government should bear the costs. Is that not correct?

MR. KENNER: I would say profit as well as cost.

COMMISSIONER GIBSON: It might be, or take the risk?

MR. KENNER: Yes.

COMMISSIONER BROWN: But if they are taking all the risk why shouldn't they have all the profit?

MR. KENNER: If C.M.H.C. do it?

COMMISSIONER BROWN: Yes.

MR. KENNER: Then they should.

COMMISSIONER BROWN: Then why not just issue government paper?

MR. KEYSER: In other words, whether C.M.H.C. sells large blocks of N.H.A. mortgages or

whether they issue debentures and give their own N.H.A. mortgages the point is here the C.M.H.C. is liquidating some of the capital tied up in mortgages that they have advanced in place of the blending of C.M.H.C. in offering blocks of their mortgages under the present system but this is just one additional way by which they can realize funds from the mortgages they hold and a way in which they extend mortgage investment to everyone.

COMMISSIONER BROWN: I think our problem is we do not see why the return to the investor today is not more than on government bonds. The government is taking all the risk and making available all the facilities for transfer or facilities for negotiability and why should they treat it on a different basis from other government bonds. In this case how does it attract the small investor any more than the present government bonds?

MR. KENNER: If C.M.H.C. were to issue debentures they would treat this item the same as C.N.R.'s where another agency of the government can either buy through this outlet that would be like the C.N.R.'s. The government could finance these total things through one person rather than through a number of them.

COMMISSIONER MACKINTOSH: Can I interject a question? Can you tell me roughly what the yield is on United States F.N.M.A.'s?

MR. KENNER: About 4 per cent and long-term United States government about 3.90, 3.95

which is slightly more than these but the tender system that C.M.H.C. now has is really a beginning. It is a way that is being used to make your mortgages held by the big investors more marketable and this is one way of obtaining the capital.

I do not think their purpose is really to dis-invest of all the mortgages they own but to broaden the market through making them marketable and this we think should be continued with a few little changes to help make it more marketable and make it more possible for dealers who have a position in it which they cannot at the present time.

COMMISSIONER MacKEEN: Mr. Kenner, is it your idea that debentures would have the same maturity dates as mortgages, say, a 30-year term, 25-year term, would it be a shorter term and be renewed at some time?

MR. KENNER: It was our idea that the N.H.A. mortgages could take longer when they are going to mature since they can be bought up. Say you had a number of issues of various terms, 15 years, 10 years, etc.,

COMMISSIONER MacKEEN: It might be that the government would be able to make a loss or profit on interest as compared with mortgages which would be lodged in an account?

MR. KENNER: Yes, there would be some. If you kept your maturity schedule such that you did not extend your average term too long you would be free of risk.

COMMISSIONER MacKEEN: Say you had a 30-year mortgage, that is what I am getting at, and a 10-year debenture and that 10-year debenture matured, it is not likely the rate would be the same?

MR. KENNER: No, it could be different.

COMMISSIONER MacKEEN: It might be higher.

MR. KENNER: And it might be lower.

COMMISSIONER MacKEEN: And how would those funds be divided if, say, the interest rate was higher, how would the government arrange that?

MR. KENNER: There would be some risk.

COMMISSIONER MacKEEN: What are your thoughts on that?

MR. KENNER: I suppose there would be some risk but there would be other things. You would always have some difference because at the present time you are paying arate of about 6 per cent and you would be financing at 5 per cent so you would be building up something.

COMMISSIONER LEMAN: I do not see in here any suggestion that this could be broadened to the whole mortgage market for existing houses instead of just new houses. Why is that? Why do we think, besides the idea of encouraging construction, why do we think of helping new houses and the owners of new housing under this superstructure of government guarantee, etcetera, and let the fellow who owns a mortgage on an old house fend for himself in the market.

MR. KENNER: I think that if the secondary market in mortgages expands - at the moment N.H.A. mortgages are the simpler thing than a conventional mortgage because of the guarantee and so on, and this is a beginning, but I think after the market did get established in N.H.A. mortgages, then it would be possible to branch out further into conventional, so that maybe an individual needing a mortgage on a house couldcome to the dealer and get a reasonable amount and price, but this is just an easy way of getting the thing established.

COMMISSIONER LEMAN: Yes, but would you recommend that old conventional mortgages on old houses be brought under this umbrella you want to build?

MR. KENNER: No, not really at this point. One thing, for a dealer or anybody to get into this thing, you must keep your administration costs and such low, and it would be difficult for a dealer to go out and check all the individual properties. He is pretty well relying on an underlying guarantee.

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If you were into conventionals you would have to do more checking and it would be more expensive, and somebody has to pay for it, so this is a start for the market.

COMMISSIONER GIBSON: Are you not suggesting that the government should do all this checking and servicing in your proposal, whereas now it is spread around amongst existing agencies? I mean, this is a sizeable additional cost that you are proposing the government should take on. You are suggesting they should do all the servicing of these mortgages.

MR. KENNER: They should be willing to do it. This would make the transfer from one owner to another one easier, if someone was willing to do it at a price regardless of who originated it.

COMMISSIONER GIBSON: But you can usually find somebody to do the servicing now at a price, can't you?

MR. KENNER: Yes.

COMMISSIONER GIBSON: In fact I think there are a lot of people who are eager to do it at a price.

MR. KENNER: But prices tend to vary.

COMMISSIONER GIBSON: Sure, but this is a market. Doesn't this happen in any market?

MR. KENNER: Yes, it does, but it is just the nature of the mortgages. If they are especiallly these government guaranteed ones, we

are trying to think of some way that would tend to make the mortgage trade on its value as a government guarantee, and so that it would change in price and such as the market generally, rather than having some other factor such as administration and such enter into the picture and change it.

COMMISSIONER GIBSON: What puzzles me is that in its nature a mortgage is not a government security. It is something related to a particular piece of property at a particular place, and there are costs involved in handling this sort of thing. You are in fact saying you wanted to unify those costs so that they are all the same, by having one organization take the risk on the whole business, is that correct?

MR. KENNER: We would be willing to, but it would still continue as now where most of them are administered by others.

One of the problems that exists now, most of the administration charges are half a per cent on the outstanding balance. This is fine at the beginning of the mortgage when the outstanding balance is large but I would think that when a mortgage gets close to being paid off and the balance is small, this half per cent that the administrator is getting is very small. It might be difficult to find somebody else to take this on, because the cost of the administrator is pretty well fixed regardless of the amount outstanding, and as they get older it

might become more difficult to get somebody to administer them for virtually nothing.

In the blocks we have sold to date we find in our attempts to interest new buyers, investors who have not previously had mortgage blocks, it has been a very strong point in favour of selling them to them that a central reliable organization such as C.H.M.C. is willing to stand by and service these mortgages in a reliable manner and at a reasonable cost.

If they were to retain the outside servicing agents and then at a later date wished to sell some of their mortgages, I think the general feeling was that possibly this would restrict the potential buyers to the degree that the trust company or bank, whoever it may be who was servicing the block, may not be an acceptable servicing agency to a potential buyer whereas Central Housing and Mortgage Corporation would be undoubtedly acceptable as service agent.

So that having Central Mortgage and Housing Corporation standing by willing to service these mortgages blocks is essential to the transferability of these mortgage blocks, if we accept the secondary mortgage business as being desirable, which I think Mr. Bates does feel.

COMMISSIONER GIBSON: Now, in other words, you are suggesting that these offerings by C.M.H.C. of mortgages have not really been

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successful, are you? Weren't they sold at fairly good prices?

MR. KEYSER: This is not a reflection on their success particularly. Rather we are in the phase of developing the secondary market when a great deal of education has to be done if we are to attract new sources of funds in this type of investment.

COMMISSIONER GIBSON: Yes, but they have succeeded, I take it, certainly it is my impression, in selling these mortgages, in somewhat improving the prices in the three auctions, I think that they have had.

MR. KEYSER: Four auctions. There has been a very gratifying response particularly by those tenderors who are used to buying them and who are willing to lay in large quantities of mortgages on simply one bid without having to initially initiate mortgages on the books themselves. But we feel that there has been not a great deal of success in finding new buyers.

COMMISSION MACKINTOSH: Have not the original buyers redistributed a good deal?

MR. KEYSER: There has been a degree of redistribution in this, purchasing them at tender by these buyers who have not yet been buyers, but of course I have not that absolute knowledge of their success in redistributing mortgages, but I take it there has been no more than perhaps five or eight new buyers interested through the previous

four tenders.

MR. KENNER: In this past tender, the fourth series, as far as we can see, there was only, of the $15 million sold, there was only ten per cent of it that went to people who planned to distribute it to other new investors, but the rest was purchased by insurance companies either for their own holdings or for some associated company.

This last one was really so successful that maybe the future ones should be bigger to allow more people like ourselves, dealers, who are interested in selling it to new people, to get into it.

COMMISSIONER MACKINTOSH: I thought the banks, trust companies are selling these blocks of these mortgages.

MR. KENNER: Most definitely, most of them again to the pension funds and such which they administer. We are trying to broaden it out so that if one trust company buys it and they do not come to that close family relationship, it spreads out to more as administrators.

COMMISSIONER MACKINTOSH: Do you suggest that the buyers are hesitant because the block is going to be administered by one of the banks, one of the well known trust companies, that this is not an acceptable administration?

MR. KEYSER: This undoubtedly is acceptable administration, but I believe you have referred

to the comment I made earlier, and I think it is even more acceptable that the agency that originated the mortgages and who is currently administering them, be permitted to continue to administer them, and in this case it is Central Mortgage and Housing Corporation.

COMMISSIONER MACKINTOSH: As I recall it, when the banks were empowered to get into the mortgage business, part of the attractiveness of this was the very widespread branch system; and the other side of the attractiveness was that it would enable the C.M.H.C. to get out of a lot of costly administration. As I understand your proposition, you want to reverse this again and put the C.M.H.C. back in and enlarge their area of administration.

MR. KENNER: In effect this has already been done. When Central Mortgage first entered the direct lending field, they did, they made their loans through other approved lenders and had those banks and trust companies, insurance companies administer it for them. It was later as the volume of directing financing grew so much that they set up their own administration nation-wide, so they are the biggest administrators.

MR. KEYSER: My belief is Central Mortgage and Housing Corporation would like to see additional private funds brought into this market and they feel this might be done though the creation of a seconary market in mortgages, and if the cost

of doing this is increasing the amount of servicing, then I think possibly this is the cost of bringing in new private funds. Now, it might possibly be done without the need to increase servicing.

COMMISSIONER MacKEEN: Have you formed any estimate what the cost would be for servicing such mortgages to the government?

MR. KENNER: As a rule the mortgage charge would be about $33 per mortgage per year, about 35 cents on the yield, and presume it must be close to that cost, giving a little profit, but if you have a pension fund you will probably want all of your mortgages, no matter where you bought them, administered by one place, whether it be trust company or bank, rather than having to deal with many administrators in your mortgage portfolio.

One of those people you might have is Central Mortgage, and the idea here of having them in it would tend to make everybody more willing to do the same thing.

COMMISSIONER GIBSON: Is it not a fact that most of the parcels of mortgages that are sold now are sold with one bank or trust company servicing them in a parcel and servicing the whole parcel? I mean, I think this is the way that most transactions occur today.

MR. KENNER: Yes,

COMMISSIONER GIBSON: There is no particular

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difficulty about that, is there?

MR. KENNER: No, it is just that whoever bought the parcels at some time in the future might wish to sell them and to rearrange their portfolio, and they might be dealing generally with a different trust company or bank and would like the new one to take this administration over; and, as I mentioned, as the mortgages get smaller and smaller, as they approach maturity, when the present way is to charge a percentage of the total, it is less attractive for anybody else to do it.

COMMISSIONER GIBSON: Basically you are saying you would like to have them get a more standardized marketable instrument.

MR. KENNER: Yes.

COMMISSIONER GIBSON: Obviously if you do that the yield runs under certain costs of development.

MR. KENNER: If they became more marketable, the rate the people would pay would go down, the home owner would pay.

COMMISSIONER LEMAN: In suggesting that this system of C.M.H.C. could not make a market in this thing, there are more implications in that, aren't there? Would you then suggest that the C.M.H.C. should accept directives from the Bank of Canada in this field?

MR. KENNER: Most definitely that it should be centralized that way.

COMMISSIONER LEMAN: Would there be some little bit of conflict of interest between the aims of the Bank of Canada at a particular moment and the objectives of the C.M.H.C. at that same particular moment, due to an inventory position they might have or something of the kind?

MR. KENNER: I do not see really much change of conflict, that they should act basically together anyway.

MR. KEYSER: In fact actually the Bank of Canada activities in the market with the support bid or with an offering, as the case may be, would be to lend reassurance to the mortgage market, but not specifically for the use of control of money supply. It would not be an instrument in that sense. In that way it would not be up to the Bank of Canada's activities in the book market operation.

COMMISSIONER BROWN: What if this centralization of everything that you are envisaging and the inevitably lower yield resulted because of a more marketable piece of paper, would they then be as attractive to some of these large buyers who like the yield but who are prepared to take the risk because they have been widespread?

MR. KENNER: I think it is quite possible, as the yield of the N.H.A. went lower, as they became more marketable, there are quite a few of these insurance companies and such who are willing

to have unmarketable securities who would tend to put more money into conventional securities and less into these. N.H.A. being marketable, you would bring more new people to replace the insurance companies for part of their investments. The tendency would perhaps also be to reduce the yield on conventional mortgages if more money was willing to go into them.

COMMISSIONER BROWN: I do not see how it is going to increase the amount of money or savings overall that comes in into the mortgage field.

MR. KENNER: Only that these were marketable which might bring more people who did not invest in mortgages, to invest in them.

COMMISSIONER MACKINTOSH: I would like to ask you one other question for my own understanding. I do not understand how you can propose a title transfer through a bank in the same way as bonds, simply for the reason that the bond is a standard instrument and a thousand dollar bond is the same in Halifax as in Vancouver; but a mortgage or parcel of mortgages is related to a specific piece of property and if you sell one in Vancouver and buy one in Halifax, well, one horse is black and the other is white - they are not interchangeable.

COMMISSIONER BROWN: Which is which?

THE CHAIRMAN: In addition to that, each mortgage contains a covenant, and the covenant is

valuable according to the credit worthiness of the man who signs it, each one is different.

MR. KENNER: We only envision this as applying to blocks of mortgages that originate with Central Mortgage and were administered by Central Mortgage and that they would not be - if a new owner bought it they would not be re-registered in the new owner's name. There would merely be a block transfer, with the ownership in such resting with C.M.H.C. as agent; and it is really who are they acting as agent for that would change, but the blocks would have to stay as blocks with C.M.H.C. being the administrator.

THE CHAIRMAN: It all depends on whether the government would be prepared to enter into this proposition and give the necessary guarantee.

MR. KEYSER: And whether one block is black as opposed to another being whiter. Really, the investor is interested in the quality of the guarantee, and in this sense he is not inclined to treat them all as equal.

COMMISSIONER MACKINTOSH: It is perfectly easy if you just make the mortgage as represented by a C.M.H.A. undertaking; in other words, you really issue a less formal debenture to cover this block of mortgages?

MR. KEYSER: Yes.

COMMISSIONER LEMAN: Eventually, when there is default on a mortgage somebody has to go through the process of foreclosing and collecting. You are trying, in effect, to insulate the ultimate lender from this whole process, are you not?

MR. KEYSER: Yes.

COMMISSIONER LEMAN: So that eventually it is the government that would foreclose in all cases?

MR. KENNER: Or it could be some approved lender that does it. But at the present time he is almost insulated in that he continues to get his full rate of interest for six months, and if it takes longer than that 2 per cent less than the rate. So, you have almost insulated him but not quite, and this again, since he is quite insulated,

you have to look at the underlying value, at what are the chances of foreclosure on a particular house -- which areas in the country are better than others. So, just to go the other little bit to completely insulate him ---

COMMISSIONER LEMAN: Would he also be insulated against calling?

MR. KENNER: No, you can get paid off before you expect it.

COMMISSIONER BROWN: How would you work that? Say somebody has a thousand dollar -- a small investor has $1,000 in C.M.H.C. debentures: How does he get insulation?

MR. KENNER: There would be no insulation if you were a large buyer of a block of mortgages -- a half a million or so. If you were a small investor and bought a C.M.H.C. debenture, there you have a fixed term bond and you are completely insulated.

MR. KEYSER: If you were to buy a block of mortgages and have some of them prepaid, this problem would not differ greatly from the problem of the large institutional investor purchasing sinking fund debentures where the only difference is in the case of sinking fund debentures he can in various ways avoid the call, and the difference is when one holds mortgages he cannot avoid pre-payment of one or two; he cannot replace them, of course.

COMMISSIONER LEMAN: Would you make these

debentures callable at par?

MR. KEYSER: The debentures we speak of here for the small investor would not be callable at all -- not necessarily. I am simply comparing a block of 40 N.H.A. mortgages and the risk of one or two being prepaid with any sinking fund debentures.

COMMISSIONER GIBSON: But these risks of re-payment vary with the times, do they not? What I mean, we have a certain structure of interest rates now, and suppose five years from now we had a considerably lower structure, the risk of pre-payment would enter considerably then.

MR. KEYSER: There are two things that protect the investor from pre-payment: First, a N.H.A. mortgage cannot be pre-paid before three years.

COMMISSIONER GIBSON: That is why I said five years.

MR. KEYSER: That would remove that clause. If the N.H.A. home owner would have by that time had to accumulate one-third of his own equity before he could re-finance it conventionally. This would be done through a market increase in the value of his property, but it is unlikey it would be possible before 10 years if the mortgage value of the property remained unchanged and his additional equity was simply provided through his monthly payments of interest and principal on the mortgage.

COMMISSIONER GIBSON: This is true, but

you can have changes that decrease or increase the chance of pre-payment, and these are not readily predictable.

MR. KEYSER: This is quite correct. This factor itself is not necessarily undesirable from the standpoint of your question.

COMMISSIONER GIBSON: No, it could work either way.

MR. KEYSER: Yes, it could.

THE CHAIRMAN: We will proceed to the second branch of the submission: Short-term capital market.

MR. KEYSER: Our presentation today on the Canadian short-term capital market concerns itself mainly with the job of corporate borrowers seeking the cheapest possible temporary capital. In so doing, the market is developed by short-term promissory notes on major corporations. We note briefly some problems that have arisen for borrowers and for those who deal in borrowers' needs.

Basically, the problems are these -- and I refer you to page 10 of our brief, section 4, which is entitled, "The Market Has Provided Its Own Solutions, But With Undesirable Consequences." The progression of this has begun with the emergence of agency agreements and has led to jobbers acting as principal in buying a corporation's notes up to an agreed upon maximum limit. In guaranteeing to buy a corporation's notes within a specified period of time, for instance, 48 hours, the jobber

has created a situation of a non-bank institution granting lines of credit to corporate borrowers against their fixed-term promissory notes. This development is impeded by banks' refusals to accept commercial paper for call loan purposes. The jobber must then resort to non-bank sources of loan funds.

The emergence of non-bank sources of funds: Corporations with funds to invest for short periods of time have recognized this need of dealers to obtain loans secured by commercial paper. Since banks refuse to grant such loans, trust company and non-financial corporate sources of funds have entered the market to fill the void left by banks. However, it would be misleading not to observe that if banks did advance loans against commercial paper collateral, the rate would likely be much higher than the yield of the collateral and jobbers would seek to reduce carrying cost by borrowing from non-bank sources when cheaper. This situation would undoubtedly have existed during 1961-1962 to the present, but not during 1959-early 1960.

Furthermore, there has been an emergence of non-bank, non-resident sources of funds for this purpose. U.S. Commercial Banks have begun to enter Canada as country bankers for earlier paper inventory. Rates compare favourably with those of domestic non-bank lenders and funds are more reliable and sizeable. The exchange hedge is handled

by the lender. This leads us to the basic premise on which this brief rests, one which we feel sincerely to be valid, and that is, it is desirable to manage credit -- "credit" here being used in the sense of the liquidity of the economy -- and in that context the developments I have just outlined, we feel, are undesirable.

From early beginnings the banks have traditionally fulfilled the borrowing needs of prime corporations at prime rates. With the emergence of a short-term capital market during the past seven years competition for banks has developed in their lending operation, since market money has generally been readily available to prime corporations at lower than prime rates. From this has grown the gulf between banks and jobbers in performing a fairly normal market function that is providing capital capital at realistic market rates. We suggest in brief that in future better jobber-bank co-operation in this area could work to the benefit of both banks and borrowers. The hypothetical institution we refer to in our brief, which we call the Merchant Bank, is simply an illustration of functions that we feel are not being properly performed but that are needed to develop a short-term capital market. We do not suggest that machinery for such an institution be necessarily considered since we believe that bank-jobbers co-operation could meet the problems in a very satisfactory manner.

We would like to answer any questions to elaborate on this.

COMMISSIONER BROWN: Would you care to comment on the extent to which such commercial paper issued by a corporation is part of its value in the line of credit that corporation has with the chartered bank?

MR. KEYSER: You are asking what proportion of the corporation's short-term needs are provided through the market?

COMMISSIONER BROWN: No. I am asking, in evaluating the short-term needs that you are negotiating from a corporation, to what extent is the value of that based on that corporation's line of credit with the chartered bank?

MR. KEYSER: Essentially, when a potential borrower comes to us seeking our aid or assistance in placing his promissory notes on the market, we must satisfy ourselves that this corporation is a good credit risk in a general sense, and part of being a good credit risk is having good relations with banks, naturally, and this is very important in evaluating the rate at which his notes will be sold on the market. But, of course, lines of credit are fairly nebulous things: You cannot get a statement from the bank to say your line of credit is such and such. So, on that basis we cannot say, "You can, therefore, issue notes up to this amount."

COMMISSIONER BROWN: No, but it is a factor that has to be taken into consideration?

MR. KEYSER: It is a factor -- but it is not a large factor with large companies, I might add -- if you are dealing with a very large corporation whose total short-term borrowings are relatively small compared to its current assets, then ...

COMMISSIONER BROWN: It presumably has a good line of credit with a chartered bank, anyway?

MR. KEYSER: I think so, yes.

COMMISSIONER BROWN: The point I am making is that this paper only becomes available because of the availability of credit?

MR. KEYSER: Right -- I am sorry: Because of the willingness of other corporations to rely on the credit ability of the borrower due to size and the lender's knowledge of the corporation's operation. I would not say, for instance, in the case of the top dozen corporate borrowers today -- I would not think that these corporations' lines of credit would be an essential consideration at all in their ability to market paper at the rates they are able to market them at.

COMMISSIONER BROWN: That is not a direct evaluation. It certainly would be, of a middle-sized corporation.

MR. KEYSER: Yes, when you get into the marginal -- it does become relatively more important.

MR. KENNER: When we speak of prime borrowers we are speaking of a very small group of companies. There are probably in the whole

country not many more than 50 which you could call prime borrowers, and it is they who can and do borrow most of the money, and the ones below that, it is not really so much a matter of a little higher rate; it is just that they don't have the market as a place to borrow. So, these big ones -- people when they buy the paper of the big companies do not even enquire as to whether there is a line of credit or how big it is with the company's bankers.

COMMISSIONER BROWN: The second question is, is there anything that you see in the statutes now that would prevent somebody setting up an organization that could not be called a commercial bank because of The Bank Act, and, if so, why has it not been done? If nothing would prevent the establishment of such an organization, why has it not been done?

MR. KEYSER: The merchant bank, as we conceive of it here, would be a fairly high grade type of operation in that it would deal primarily with deposits and pay interest on these and make loans to other corporations against the security of their promissory notes.

There are only currently two institutions in Canada that could possibly fulfill this function. One is the Chartered banks and the other is trust companies. I suggest that certain capital requirements of the chartered banks for these purposes are fairly large at this stage in the development of the market and there are certain limitations on trust company operations with respect to transactions in promissory trading. From that point I think these are essentially the restrictions that have prevented this type of operation.

COMMISSIONER BROWN: Why could not an entirely new company be set up to do this?

MR. KEYSER: A new company undoubtedly would have to comply to certain regulations and it should really be in the Bank Act, I would say. There is no provision made at the present time for this type of operation to be established.

COMMISSIONER BROWN: I am a little disturbed that everything has to be incorporated before it can be established. Why couldn't it be established because of the exigencies of the market?

MR. KEYSER: I think possibly the jobber

group in Canada is more likely aware of the emergence of the short term capital market than perhaps other institutions might be.

COMMISSIONER BROWN: I think the banks are aware of it.

MR. KEYSER: Well, yes, in that it conflicts in a way with an established bank function and that is the advancing of loans at prime rates and in a sense for years this function has been very, very well performed by the banks but we are now coming to the point where large group lenders with temporary cash balances are willing to lend to other corporate organizations with capital needs at rates that are considerably less than prime rates and in fact I think we observe in the report that the rate spread on average over the past five years has been approximately one and a half per cent.

THE CHAIRMAN: Do I understand that you propose that some new institution should be set up to handle this sort of business?

MR. KEYSER: Actually, no.

THE CHAIRMAN: A blending institution?

MR. KEYSER: There is a need for the blending function in the market.

THE CHAIRMAN: I thought what you said went further than that. Am I wrong?

MR. KEYSER: We feel that the merchant bank is an illustration really of the need for the performing of those functions or at least to

illustrate the fact that these functions are not being performed. Frankly, I feel that if something could be done to fulfill this function without resorting to a new type of institution that it would be even more acceptable.

THE CHAIRMAN: Yes, you refer to the merchant bank in the short term capital market and then you go on to discuss what this institution would be. I thought that institution was to solve the problem. Is that right?

MR. KEYSER: The merchant bank is merely one suggestion. We have heard just recently that a couple of the banks are considering lending at closer to market rates on promissory notes in the way that they lend money on other kinds of collateral. If this were to be the case then the merchant bank or blending institution would be unnecessary anymore.

MR. KENNER: This way jobber co-operation would fulfill the function.

THE CHAIRMAN: Well, what do you suggest that this Commission should recommend to solve the problem that you feel is a serious one?

MR. KEYSER: We feel that the problem could be solved if the banks would become willing to accept short term promissory notes of large corporations.

THE CHAIRMAN: Suppose they are not willing to accept them?

MR. KEYSER: Then the alternative is an institution that permits --

THE CHAIRMAN: Then why not go ahead and form one? Who is to provide the institution - the government or somebody else? If someone else is to do it that is a matter that could be solved if you could persuade somebody to do it.

MR. KENNER: Well, a study of the whole thing that is going on because of your deliberations will make it quite possible that some time and thought will be given to it and that such an institution -- that some of the interested parties may try to establish such an institution themselves if we still have to live within the acts that are there at the present time.

MR. KEYSER: To a degree jobbers have begun this function by acting as principals in purchasing short term promissory notes and financing them as best they can with off street lenders but this in itself creates certain problems that result in pressure on market rates for their short term loans.

COMMISSIONER GIBSON: To get some perspective on this question I think it would be very helpful if you would give us your views on how the short term money market has developed? You have said earlier that there has been quite a development in this market since 1954. Has it been a growing, developing market over the eight years or so since it started?

MR. KEYSER: The portion of the short term market we refer to here -- and we will limit this to the money market or short term market for corporate borrowers and lenders to corporation --

COMMISSIONER GIBSON: Right.

MR. KEYSER: Back about 1955 or 1956 or perhaps even as late as 1957 there came a time when large corporate investors became aware that associate companies or companies with whom they were fairly close needed temporary capital at times that the lenders themselves were long cash. The corporate lenders were able to put their money to work in short term Government of Canada obligations or other forms of deposits at market rates. The corporate lenders, on the other hand, were able to borrow temporarily that additional at bank credit at fairly high rates relative to the market.

Certain groups with whom we are familiar did get together and did lend one to the other at an advantage to both of them somewhere in between market rates and bank prime rates and from this time with the assistance of jobbers this market has developed considerably.

COMMISSIONER GIBSON: And it has grown to a considerable size?

MR. KEYSER: It is difficult to estimate the amount of borrowing that is done by corporations in this country but I would suggest there are 50 to 60 borrowers in Canada today who do this

and their total borrowing requirements over the past two years or the past year or so would have been approximately $400 million.

COMMISSIONER GIBSON: How much do you think would be in the market at any given time in the way of paper, that is, in some recent time?

MR. KEYSER: At least half that amount.

COMMISSIONER GIBSON: Half of the $400 million?

MR. KEYSER: Yes. Some of this you see reflected in the off street loan figures prepared by the Investment Dealers Association and they, of course, through the recent survey have figures which they have attached to their brief which we do not have access to at this time.

COMMISSIONER GIBSON: Does most of this business come through dealers or is some of it done directly?

MR. KEYSER: I would say that almost all of it goes through dealers.

COMMISSIONER GIBSON: There are very few corporate treasurers who deal directly with each other?

MR. KEYSER: Well, it is more convenient for the lender to go through a dealer because he can then no longer be accused perhaps of something less than an arm's length transaction and, furthermore, the lender now has a much wider choice of promissory paper and rates do vary from day to day and hour to hour and the dealer is a

professional bringing a lender together with a borrower and to some extent the lender may have funds to invest for 30 days whereas the borrower may not want to borrow for that length of time. So that the jobber performs this blending function that is referred to here.

COMMISSIONER GIBSON: Would you say something about the degree of sensitivity of this short term corporate paper in regard to monetary conditions?

MR. KEYSER: Over the past five years it would appear that there have been ample -- with one exception, 1959 and early 1960 -- there have been adequate funds to support the borrowing requirements of the very prime corporate borrowers aside from the finance companies and at many times during that five year period the market has had ample funds to supply even the needs of some marginal borrowers.

COMMISSIONER GIBSON: There would be quite wide ranges in interest rates then over that period?

MR. KEYSER: Right, and I would say at the present time and until recently there have been such supplies of corporate funds in the market that very, very marginal borrowers have been given a look at by potential investors.

MR. KENNER: The rates themselves are extremely sensitive, varying almost as much as or more than even treasury bills.

COMMISSIONER GIBSON: And varying, I take it, quite closely in harmony with the treasury bill market?

MR. KENNER: Very closely. The treasury bill is one of the main guide posts of establishing all these rates.

MR. KEYSER: Generally speaking I might add that prime commercial paper rates generally vary from one-eighth to one-quarter of one per cent above the rates published by leading finance companies at times when those leading finance companies are in the market for funds in all categories and it is going down.

COMMISSIONER GIBSON: Secondly, you would have a good deal wider variation in rates, in other words, there are some borrowers who would have to borrow at a good deal higher rate from time to time?

MR. KEYSER: Yes, until you get to the time where, assuming the availability of funds, these increasing rates get to the point where the borrower has no longer got an advantage and he then does his borrowing from the bank jobber.

COMMISSIONER GIBSON: What are the usual terms of this paper, time terms?

MR. KEYSER: Very seldom does commercial paper exceed 90 days in term and more recently borrowers have shown a desire to borrow on a two-way call, that is, on a 24 hour call with a call option both to the investor and to

himself.

COMMISSIONER BROWN: Such a two-way call frequently involves a rate differential?

MR. KEYSER: Yes, when it is a ~~t~~two-way call generally the rate is one-eighth above what it would be if it were called only by the investor. In the case of one-way call-outs the borrower protects himself by placing a period on it, normally 30 days.

COMMISSIONER LEMAN: Is it your impression that a charter to such a merchant bank today would be refused unless there was special legislation passed to recognize this type of financial institution?

MR. KENNER: I think it would have to be fitted into the Bank Act or at least into the operations of the Bank of Canada so that there would be adequate control of its operations. If that could be fitted in, I see no reason why it probably would not be granted but again this is a fairly new market and it is possible that somebody will try in the near future. They just have not yet.

COMMISSIONER MACKINTOSH: Is there anything to prevent one of the firms presently operating a market from expanding its operations in the direction of a merchant bank function?

MR. KENNER: No, I do not think there is anything. It is just that it cannot be really just an extension of the dealers' operations so

much. I think you want at least the depositors in this operation would want it to be a separate entity rather than just an addition to the dealers' operations.

MR. KEYSER: I think one of the discouragements to this development at the present time is that the market is only just verging on the point where it would be attractive to do this and as a result we have not seen a great deal of activity in this direction other than to observe that several jobbers are buying commercial paper at one term, the other at shorter terms. In a sense they own it and they put it out among the off street lenders on loan and in this sense they are performing this function to a degree.

COMMISSIONER MACKINTOSH: Is the acceptance of deposits an essential feature of such an operation?

MR. KENNER: It would be necessary to get most of the money that you would use to finance the commercial paper from deposits or notes or something of probably shorter term.

COMMISSIONER MACKINTOSH: Well, we seem to hear of quite a few institutions who undertake such operations and branch into the deposit business although not set up as depositors?

COMMISSIONER LEMAN: Do dealers now accept deposits in a certain form?

MR. KENNER: Generally, no.

MR. KEYSER: I believe there are certain

[illegible]

restrictions on their paying interest on deposits. I believe the restriction hastto do with the Toronto Stock Exchange.

MR. KENNER: In fact, you have deposits from those customers who have sold something but have not told the dealer to pay them but they are not really deposits of any size.

COMMISSIONER MACKINTOSH: Just balances from their other investments?

MR. KENNER: Yes.

COMMISSIONER BROWN: You could buy them, couldn't you?

MR. KEYSER: Yes, it could be looked at in two ways. It is a sale, the dealer has sold securities for a shorter term than shown on the actual security itself, particularly if the ultimate maturity does not exceed the re-purchase date by a great deal and if that paper is readily marketable between the time the dealer repurchases it and its maturity and it could be conceived of as an outright sale in this sense that it is simply a favour to the buyer that you are tailoring the security specifically to his needs and in that sense it couldbe looked at as accepting a deposit. If the market is in such a condition at the time that the dealer has inventory that he is unable to sell at advantageous prices in which case he offers it on loan in a sense with a depositor.

COMMISSIONER BROWN: By that agreement he is in effect putting his name on the paper as

well?

MR. KEYSER: But simultaneously, of course, the dealer contracts to repurchase it so that it shows on the dealer's books as a contingent liability.

THE CHAIRMAN: We should adjourn for a few minutes unless this is the last question.

COMMISSIONER LEMAN: I have a couple of questions.

THE CHAIRMAN: Well, go ahead unless there are some other questions. I am not trying to close anything off but we usually adjourn for a break in the morning.

COMMISSIONER LEMAN: In one answer you made to Dr. Mackintosh a few moments ago you got close to a point which is not really covered in the brief but I would like your views about it. Do you say there would be merit in a separation of the function of a jobber or dealer and that of a broker - and I am not talking specifically about this restricted field now but I am talking about the field in general?

MR. KEYSER: Jobbers as opposed to investment dealers?

COMMISSIONER LEMAN: No, dealers as opposed to brokers in the whole field of securities.

MR. KENNER: I do not think that any separation would be really an advantage if the two functions are -- where a lot of dealers are merely servicing different parts of the investors' needs

and there is an advantage to have them together because it is just fulfilling a slightly larger need for the investor. But if you had a banker in the group also maybe there would be an advantage having it slightly separated when you are taking people's deposits and such.

Page 1217 Follows.

COMMISSIONER LEMAN: How about the specific function of the dealer as an underwriter?

MR. KENNER: Then being a broker also, you mean?

COMMISSIONER LEMAN: Yes.

MR. KENNER: Having them all under one roof as they are now, merely makes it easier to fulfill all the functions. I cannot really see any advantage in the split.

COMMISSIONER LEMAN: Do you see some disadvantage?

MR. KENNER: Of splitting it?

COMMISSIONER LEMAN: No, no, you say that it has an advantage of having them under one roof. Do you see some disadvantage?

MR. KENNER: No.

COMMISSIONER LEMAN: None at all.

MR. KEYSER: Except that I think the function of a large investment house as an underwriter of new securities, as a seller of those securities to both individuals and corporations and as a broker in providing secondary markets in those securities, I think that these functions are complementary, and with the development of the short term money market this too complements the underwriting function in that it puts to work temporarily funds that are realized by new underwriting and it assists in handling funds that are generated by your closed account and by other accounts. I think there would be disadvantage if

[illegible]

it was only due to lack of communication among these different functions.

THE CHAIRMAN: Any further questions? Thank you very much, gentlemen. We will now adjourn for about ten minutes.

--- A short recess.

SUBMISSION OF JOHN R. CAMPBELL, Q.C.

MR. CAMPBELL: My lord, Mr. Chairman, and gentlemen. I feel a little presumptuous appearing, in that I am appearing just really as an interested person, perhaps with some experience in the National Housing Act market, with some thoughts as to the primary markets and the problems and questions that people have with respect to it, and also with perhaps some thoughts about the growth of a responsible secondary market for N.H.A. mortgages, and with some thoughts as to the extension of secondary market activities to conventional loans.

I feel perhaps the most important point that I have to make is that over the next few years, according to many economists, there will be some wild number of housing units of one kind or another required to be produced in this country, and a great deal of it falls within the purport or the intent of the National Housing Act as it is designed, in the recital of the Act, to encourage the building of medium and low-class, lower income family housing. The figures seem to be rather staggering in relation to the response of the market today, and particularly in the last five years, and it seems to me that there are some real problems, before we had the National Housing Act 1954, in relation to the size of our country - perhaps even before 1957 came along. Our institutions were able

to furnish the mortgage money required over a longer period of time, and I feel that if we as a nation constantly grow and need more houses, that perhaps our institutions ought to have grown or adapted to be able to do what they have in the past.

Something seems to be wrong, in that the government has found it expedient to provide a very, very substantial portion of the mortgage money that has gone into loans insured under the National Housing Act, and it would appear that unless some new stimulus to mortgage lending and, in particular, mortgage lending in mortgages insured under the National Housing Act, unless some new stimulus is given to the lending pattern, that we are going to form a very bad habit and become almost completely dependent upon government.

I had the privilege of sitting during the first submission this morning and the first part of it relating to this subject, and I am sure I am not supposed to start debate with somebody who spoke before me, but I took violent exception to the statement that was made or the advocacy for a Canadian "Fanny May".

I do not see why the institutions we have, plus perhaps additional servicing institutions, cannot handle our requirements if we tailor our product to more or less our usual conventional way of doing business.

I see no particular merit in saying to some individual, be he a lawyer or what he is, that the government will guarantee the mortgage on his house. In fact when people talk about guarantees, right now under the National Housing Act there is no such thing. It is an insurance obligation and there are some conditions that have to be met. It cannot be spoken of in the same terms as a guarantee, it ought not to be spoken of as a guarantee and I do not think it ought to be a guarantee.

If it is a guarantee, then I would agree with perhaps how Mr. Gibson put it, I think, who said that the government should just issue direct bonds and put money directly into loans, and then we do not really have a problem in the primary market or in the secondary market.

I also heard a comment from the Commission that things seem to have to be encouraged before they are established. I think that a responsible secondary market, which will have certain benefits and will take some time to grow, will be established without encouragements, but perhaps with only the removal of a few little technical problems that seem to slow down the establishment of it.

I would refer the Commission to the part 2 of the current Central Mortgage and Housing Corporation report, where they discuss the mortgage market, and I am sure you probably read it.

I agree with a great deal that is said in here, a great deal, and I think the intent is tremendous. Referring to the last paragraph it says:

> "Government activity in 1961 in the secondary market is based on the expectation that with the development of greater knowledge and familiarity --"

THE CHAIRMAN: Mr. Campbell, usually we prefer to hear your summary of your submissions.

MR. CAMPBELL: I am sorry.

THE CHAIRMAN: The proposals that you make, and these various other pieces of information that you may have might be developed if there are any questions to be asked.

I notice in paragraph 8 of your summary there are certain recommendations that you make which no doubt will be interesting.

MR. CAMPBELL: In summary, I recommend that certain defects in the N.H.A. instrument be cured, so that there will be a more responsive primary market for N.H.A. mortgages, and that present institutions adapt and new institutions will come into being to assist in the growth of a more active secondary market. The specific recommendations that I have are contained beginning at the bottom of page three of my submission in paragraph eight.

Firstly, to cure some of the minor defects in the mortgage, but which are acceptable apparently only to sophisticated lenders and not

to the uninformed lenders, and therefore must act as a deterrent from a broadening of the market.

(b) To have C.M.H.C. in the sale of its mortgages, not only the billion and a half it has in portfolio now, but the mortgages that it ultimately apparently must acquire from time to time in the future on a basis which will appeal to the greatest number of potential buyers.

(c) I believe it is most desirable to have the facility of the Canadian chartered banks operating in the mortgage market, particularly the N.H.A. market, not only as lenders but as servicers. I think that that facility would tend to become more available if there were no impediments, real or imagined, to banks lending and making N.H.A. mortgages. I believe that all mortgages in the market ought to have the same features as to the insurance obligation behind them, so that they would all be marketable on more or less the same basis, which is recommendation (d).

With respect to the new institutions which could come into being and service a secondary market and also provide an alternate primary market, I believe that small impediments as exist in the Canadian and British Insurance Companies Act, ought to be amended, so that such companies may issue and sell their securities in the most sure but in the cheapest form as to cost.

I feel finally that C.M.H.C. has a broader

function to perform than it is currently performing, and these functions are briefly - it is not a function, this is a recommendation, this first point - that it should sell its mortgages on a different basis, that it should be a lender of last resort, it should provide standby commitments.

There are some helpful hints in the way various government agencies operate in the Federal Housing Act and other American acts, and I think as a result of these things that over a relatively short period of time we would find ourselves in Canada in most periods of time, with a completely adequate flow of private funds for N.H.A. mortgages and, as a result of that, will be able to seriously consider extending N.H.A. loans to used housing and would find that our conventional mortgage market would improve as well.

Mr. Chairman, that is the basis of my submission.

THE CHAIRMAN: Thank you. Questions?

COMMISSIONER LEMAN: Mr. Campbell, now that you have read out the complete summary of what you recommend, I would like to encourage you to make the point you were going to make about the report C.M.H.C.

MR. CAMPBELL: I took the liberty, incidentally, of submitting some questions because I was advised that perhaps the Commission was

interested in questioning, and perhaps what I have to say here affects one of those questions, but the last sentence of the paragraph says that it is the intent of the Corporation in doing what it has been doing, to encourage a market primarily based on private sources of capital.

"The Corporation's activity in this field is not intended as a device to raise cash for its own lending operations or for other government purposes. The secondary market will serve a useful purpose only if it brings in to the mortgage field new investors."

And so on. I agree that this is a very desirable intent. I question seriously whether the method that C.M.H.C. is going about this will actually have this result. It will in some areas but I think in the end result I question seriously that it will.

Perhaps the reason I question this is made in the brief where I point out that the C.M.H.C. improves their mortgage to some extent over other mortgages that are available.

THE CHAIRMAN: What page of the brief were you referring to?

MR. CAMPBELL: Page eight, item (b). This perhaps is a technical point, that as to the acceptability of title of mortgages on default, that I have made a specific recommendation in detail as to how this might be amended, but the terms

upon which C.M.H.C. sell their mortgages removed this as a problem, because they tell you when you buy a mortgage from them that when the mortgage comes back the title you get was acceptable and will still be acceptable then.

COMMISSIONER LEMAN: Mr. Campbell, before we touch on the financial implications of this, there is one thing I would like to be a little clearer on. You have made a very thorough analysis of the problems connected with this whole field from a legal standpoint. This is a field in which the Commission cannot delve very much, but I would like to get your views on the extent to which it would reach the objections that you have in mind. One would be to convince the provinces, for instance, in the field of registration, foreclosure procedures, all that sort of business, to get more uniformity in the practices, etcetera. Is this a big obstacle?

MR. CAMPBELL: Perhaps I can answer your question in a different way, in that I have concentrated here on certain legal aspects. Perhaps I could have concentrated more on the problems of foreclosure in Alberta or some of the other local problems, on the form of the instrument, transferability of a mortgage and so on.

I do not think these are important problems that impede the growth of a secondary market or the enlargement of the private primary market to satisfy our country's needs. They are

little problems of doing business and they could be cured, they will be cured, but I do not think they really impede the growth of the market, primary or secondary.

COMMISSIONER GIBSON: On the nature of the problems, Mr. Campbell, you make a point that there is a large gap in this area that, looking ahead, you do not see too well filled. This is a long term view. You are not talking of to this particular moment.

MR. CAMPBELL: No, sir.

COMMISSIONER GIBSON: You are looking ahead, what, a decade?

MR. CAMPBELL: I would say ten years.

COMMISSIONER GIBSON: And you are concerned about there being a continuing gap over that period if means for channelling funds in this direction are not improved?

MR. CAMPBELL: Yes, sir, I think perhaps it might have been shown in widened terms.

COMMISSIONER GIBSON: What would you say the present situation was?

MR. CAMPBELL: Right today?

COMMISSIONER GIBSON: Yes.

MR. CAMPBELL: Well, I think right today as opposed to, for instance, last year, most people who wanted to get N.H.A. mortgages can find them in the private market.

COMMISSIONER GIBSON: So we have had what you regard as a temporary but quite marked improvement recently in this particular direction.

MR. CAMPBELL: Yes, we have had this several times before in the last six or eight years, and I can foresee that we would still have these periods from time to time.

COMMISSIONER GIBSON: And you think that such kinds of things that you have in mind, developments occurring in this sort of direction, that the supply of funds for C.M.H.C. mortgage purposes would be more even, less variable than it has been?

MR. CAMPBELL: If I may just refer a moment to a study in the United States by Professors Oliver Jones and Leo Grobler of the University of California on the subject of the secondary market in the United States, with particular emphasis of F.H.A. and V.A. loans.

Their comments are -- and I would agree with this in general -- that the secondary market as it has developed in the United States, which according to them is unsatisfactory, has not as yet tended to even the flow of funds into government insured mortgages. On the other hand, a secondary market, if it is responsible and responsive, ought to tend to even the flow of money into a particular market. They make a point in this book --and I think perhaps it is a sensible point -- that during periods of tighteness of money, restrictions of credit, and so on, municipalities are still able to raise the funds they require. In the case of municipalities, it is a function of interest that they are willing to pay, whereas in periods of tightness money mortgages do disappear.

COMMISSIONER GIBSON: In the case of municipalities you have a variable interest rate; the money can be obtained at a price; is that the point?

MR. CAMPBELL: This is the point.

COMMISSIONER GIBSON: Whereas you don't have the same variation of interest rate in this area, and sometimes money cannot be obtained?

MR. CAMPBELL: This is correct.

COMMISSIONER GIBSON: But this is one of the objectives you have in mind, to get a somewhat less variable flow?

MR. CAMPBELL: Yes, indeed, and I believe our particular system in Canada, helped on by the particularly outstandingly good feature of the

National Housing Act, and that is the cash settlement as opposed to a 20-year debenture of insurance payout, is the kind of thing that can create a mark of confidence in a mortgage so that the paper can survive within reasonable interest limits in periods of money tightness.

COMMISSIONER MACKINTOSH: Why should mortgage interest rates be sticky and unresponsive -- more so than changes in other parts of the market?

MR. CAMPBELL: Well, I am not sure I am qualified to answer your question. I will take a stab at it.

COMMISSIONER MACKINTOSH: I am not sure I am qualified to ask it.

MR. CAMPBELL: Well, put it this way: I would rather be asking it than answering it. Mortgages, as has been mentioned this morning -- and I think it is probably pretty generally recognized -- are specialized pieces of paper. As this C.M.H.C. report says, they requirea certain amount of expertese, and when this expertese in Canada seems to be pretty generally concentrated in large institutions, and these large institutions have other investment objectives as well as just mortgages, let alone just N.H.A. mortgages, the problem of going into a 20 per cent N.H.A. loan is that as soon as the rates fall to 15 per cent it will be pre-paid, and besides all that our respectable large financial institutions would not dare get involved in a 20 per cent loan to start with -- and I am using violent figures to

make my point. I think that investors, particularly institutional investors, tend to shift to non-mortgage investments when the interest rate on non-mortgage investments comes up to what they consider to be reasonable, and therefore they do not have to reach for the higher rates on mortgage investments, which higher rates they will lose as soon as the fellow can re-finance. He can get himself a good 15-year province of Ontario bond of some sort at a pretty high rate, so he is probably going to take that 10 years, for certain, and in the course of doing so properly fulfill his obligation to the shareholders to earn money, because three years hence the mortgage rates will be down and the fellow who paid you 6-3/4 or 7½ is going to be around to re-finance. I think perhaps you get the shift from mortgage to non-mortgage investments.

COMMISSIONER BROWN: Would you like to see them more responsive -- some way they can be repaid for a longer period?

MR. CAMPBELL: I hesitate to say this, but I think mortgagors have more protection than mortgagees, and there are some areas of protection of investment which have a beneficial consequence where restrictive rules in favour of mortgagees could be established. The government did one of these not too long ago, in that they made N.H.A. mortgages on multiple housing -- apartments and various multiple housing units where they are not dealing directly with the individual -- from corporate borrowers non-

repayable for ten years. As the result of that particular move, it seems to me when you have perhaps an average life of 14 years on these loans that a pretty stable financial arrangement can be made. which is not subject to every little variation.

COMMISSIONER BROWN: My next question I would like to get back to the previous discussion and proposition and one of your objectives and is to get a reasonably steady flow of money into the mortgage field. If this were accomplished, wouldn't this, in fact, insulate the mortgage field from monetary policy, and is this also your objective?

MR. CAMPBELL: No, quite on the contrary, I don't think it would insulated it from the whole monetary field, and it is certainly not part of the objective. The objective is to try to have interest rates on mortgages flow with interest rates on other costs and to have the money available at the price it takes to get it available. I feel thatyou should concentrate on trying to improve the instrument, and I have suggested two ways of improving it -- the investment interest: One, by curing some of the defects that cause the primary market to be reluctant to go into it in volume; and two, create a debenture as of a more liquid and more marketable form of indirect investment which could support both additional primary investment and secondary market activity, and those things certainly are not in any way insulated from monetary policy.

COMMISSIONER BROWN: But if the flow of

money is to be evened out, it means in times of tight money there is still the same amount of money available for mortgages as in times of easy money -- or , just at different interest rates?

MR. CAMPBELL: This is perhaps going to a specific recommendation which I have made. It seemsto me that nothing is going to even the flow of money into anything. You always have the point of choice of investment, and I don't think, unless you do it solely through government, that you can control it. You certainly can use the function of government to assist it. I think in the long haul of establishing a secondary market for secondary mortgages where the investor's requirements change, and he has to get rid of mortgages with as equal ease as he could get rid of bonds, then I say you have acoomplished something, but until that time has arrived --- and it may never arrive; you will continue to get to it -- but in the immediate short-term government ought to be able to perform its function of where it sees it is necessary to keep the housing industry going -- and this is certainly desirable -- to make lower interest rate loans, or take part of a loan, give the mortgage investor, the bank or the trust company, or whoever, a take-out for two years hence so that there is some method of at the present time keeping the investment interested in going into N.H.A. mortgages instead of just cutting them right off. As I said a shift from mortgage to non-mortgage investments would do.

COMMISSIONER MACKINTOSH: You want them to have a dependable share of the market and not just a residual?

MR. CAMPBELL: Yes. There are lots of other things involved too. The market for the end products has to be borne in mind, but this surely is the point of decision of the builder, the developer and so on -- whether he wants to take that risk.

COMMISSIONER GIBSON: But you are hoping also to see a larger relative flow of funds into C.M.H.C. mortgages, as I understand; is that correct?

MR. CAMPBELL: Yes. It appears that the private market could on an average more than double its present investments into N.H.A. mortgages on some average regular annual basis.

COMMISSIONER GIBSON: Where would you envisage these funds as coming from?

MR. CAMPBELL: It does not create any new capital.

COMMISSIONER GIBSON: You mean this replaces government funds?

MR. CAMPBELL: It replaces government funds. It does not create any new capital, attempting to do this. It may create some new capital in that it drives down interest rates -- it tends to drive down interest rates -- and gives builders the opportunity to make savings so that there is a very small, perhaps, growth of new capital or available-for-something else capital; but I just think this segment of the money market, which is large, should be

able to compete for the available capital all round.

COMMISSIONER GIBSON: But you see this growing, don't you?

MR. CAMPBELL: Oh, yes.

COMMISSIONER GIBSON: And under that housing agreement, particularly with this increase in the population, in the number of people of marriageable age which is going to occur very soon, doesn't that mean that more funds will relatively be needed now?

MR. CAMPBELL: Mr. Gibson, I have said that it would appear from 125,000 to 150,000 new housing units per annum -- and if I were to be pinned down I think I would probably take a stab at maybe an average of 145,000 over the next 10 years, and a large amount of this type of housing should fall within the purport of the National Housing Act, in that it is for middle-income families, and that is rather closer to the $900 million available than to the $600 million figure I have in here. The private institutions sort of tend to average out more than $300 million over the last few years. There is a very large gap.

COMMISSIONER GIBSON: But you think of this gap as being mainly not a gap in the total financial requirements of the country, but a gap in the sense it is now being provided by government rather than through private sources; is it correct to put it that way? In other words, you are thinking of a stage of more private funds going into this area

and less government funds?

MR. CAMPBELL: Yes, that is definitely correct.

COMMISSIONER GIBSON: If you have such a stage, does it follow the private funds will come from the same source as the government funds? The government has to raise its money in the market or through the tax system.

MR. CAMPBELL: Yes.

COMMISSIONER GIBSON: So this may have a different effect on the economy.

MR. CAMPBELL: Well, yes, if you have another $500 million competing for the available investment funds in a year it certainly would have a lot of effects.

COMMISSIONER GIBSON: Have you thought about this very much? Do you see it affecting the market for other obligations?

MR. CABMPELL: Well, it certainly seems logical that it would. This is a fairly large requirement of money in a country of this size. It seems it would certainly drive other borrowers to other markets at higher rates.

COMMISSIONER GIBSON: But would those borrowers be the government of Canada and other governments in particular -- maybe this is going too far afield?

MR. CAMPBELL: No, I don't think it would be, because their credit in the money market is always a little better than -- unless you provide

the housing money by government bonds -- their credit is always a little bit better, and the rates of interest they have to pay. I think it would probably drive some aspects of the commercial borrowing and some aspects of municipal borrowing -- perhaps make them more competitive.

COMMISSIONER GIBSON: It would be really rather hard to do because relatively you are trying to make the C.M.H.C. mortgage into a more interesting thing relative to everything else?

MR. CAMPBELL: Yes.

COMMISSIONER GIBSON: So, how much other kinds of instruments would be affected you could hardly determine in advance?

MR. CAMPBELL: I am sure it would be hard to determine in advance, but the other side of that question is the way the N.H.A. mortgage is now: Why should it be singled out for special treatment; why should it be a political football; why should it be all of these things? If there is the possibility of creating competition with the other non-mortgage investments, then we ought to be looking hard at that possibility.

COMMISSIONER MACKINTOSH: Following on from that, Mr. Campbell, where do you think there are the sources of capital for these N.H.A. mortgages that are at present not being used?

MR. CAMPBELL: Well, I understand that pension funds which are growing and will continue to grow currently only have 8 per cent of their

assets in mortgages and I believe that if the mortgage could be made a more attractive piece of investment paper either directly in the mortgage or a bond secured on a mortgage that pension funds and pension trustees will be more favourably disposed to go into mortgages and take these slightly higher yields from government bonds.

I believe -- and this perhaps particularly goes to the question of the sale of bonds secured on mortgages -- that you have a more attractive piece of paper to get at people's savings in this form of investment. I feel if you have entities, not just one but competitive entities in the market that are financing their requirements through the sale of bonds, that it is feasible to get more of the monies available in the short-term money market. I mean, for instance, every year some principal is paid off a mortgage. Well, surely for that year you could finance that mortgage requirement in the short-term money market.

And then I think you could attract foreign capital and on a borrowed basis I am sure it must be more desirable than to have it on an equity-ownership basis. Here again, particularly in the form of bonds or debentures secured on mortgages you could create a piece of paper which, for example, in the United States could qualify for investment by, say, two-thirds or three-quarters of their investment market opposed to a Canadian mortgage which has a very limited number of possible investors.

Most of them who could possibly have any interest are here already.

So that there certainly is a broad opportunity to import capital on a borrowed basis which is most desirable as opposed to equity through this method.

COMMISSIONER GIBSON: Looking at the import, how do you cope with the exchange risk in selling mortgages outside of Canada?

MR. CAMPBELL: Well, it seems that there have been times in the last year or one of them when you could have sold all the Canadian pay securities on the foreign market in New York, secured on N.H.A. mortgages that anyone would have wanted to do last year.

COMMISSIONER GIBSON: All Canadian pay?

MR. CAMPBELL: All Canadian pay.

COMMISSIONER GIBSON: Of course the buyer would have paid the exchange?

MR. CAMPBELL: Yes.

COMMISSIONER GIBSON: Are there many times when this is the case?

MR. CAMPBELL: I would rather have you answer that question. Sure that has happened. I have been interested in this subject for some time and this was about the third time this has happened in six or seven years.

COMMISSIONER GIBSON: So you think an alert organization would see these opportunities and use them?

MR. CAMPBELL: Oh, absolutely. There was an opportunity to sell all the 6-3/4 per cent mortgages held by Central Mortgage and Housing Corporation at a fair price, not that thatwould have accomplished anything more than what has been accomplished already -- maybe even accomplished less but the opportunities do arise.

COMMISSIONER LEMAN: And the C.M.H.C. itself did not try that market?

MR. CAMPBELL: This was not a market for direct investment in mortgages. This was a market for investments in bonds secured by mortgages.

COMMISSIONER LEMAN: If, as you say, the gap is very large and the investment by C.M.H.C. shows that it has been large, how much of this gap would this foreign source in your opinion fill?

MR. CAMPBELL: Well, going back to Mr. Gibson's line of conversation I would think that the N.H.A. requirements of direct investment in improved mortgage and investment in bonds of a mortgage company would compete in any Canadian market and certainly get some of the Canadian capital which would leave some other part of the Canadian capital market requirements short and that the sort of excess would have to go outside. Some of that, of course, would be directly for N.H.A. mortgages, some of it would perhaps be for the bonds of a bathtub manufacturer -- I don't know.

COMMISSIONER LEMAN: Mr. Campbell, you are thinking of the United States market, I gather

when you say foreign?

MR. CAMPBELL: Yes.

COMMISSIONER LEMAN: If this is true does it mean that through pushing interest rates down quite low in the mortgage field in the United States itself through the various means they have used down there, isn't there a gap down in the States that is quite large if you eliminate governments?

MR. CAMPBELL: Well, I am not an expert on the American mortgage financial market. I included in this brief a paragraph at the end relative to what Fanny May's operations have been and Inote the fact they are a buyer of mortgages but proportionate to Canada, that is, with C.M.H.C.'s direct investment in mortgages, they are just an evening of the market. I have also read what this American study of the secondary market has to say on the subject and they seem to feel that government via the various entities other than the Fanny May organization itself is not a net large investor in mortgages.

So that by the use of all of their various little techniques and mortgage bankers etc. -- this is a much more complex market down there -- they seem to be able to take care of a large part of their mortgage requirements without having had government investment in it.

COMMISSIONER LEMAN: In other words, they do not have the same gap as we have up here?

MR. CAMPBELL: They do not seem to have it

and they do not seem to be likely to get it although they complain their secondary market is not operating effectively either but they are well on the way to using their various government and non-government instrumentalities to solve these various problems. Their government instrumentalities seem to be primarily warehouses and that is how they tend to even the flow. They warehouse mortgages or give commitments or do something like that during the periods of credit restriction.

COMMISSIONER BROWN: Do you think that the development of some institution into a building society with authority to invest in N.H.A. mortgages would serve any purpose in Canada?

MR. CAMPBELL: I think it might serve a purpose but I am very taken with the fact talking to many of banker friends that we have perhaps 3,500 out of 5,500 bank branches that could serve as mortgage dealers so that we have those facilities and we are not using them fully and we are being a little stupid. We do not need either mortgage competitive outlets or servicing agents; we have more than enough. What we need is routes to the capital.

COMMISSIONER BROWN: This could be resolved by getting the banks to become involved?

MR. CAMPBELL: It would tend to resolve by directing banks to be involved, taking these artificial restrictions out of the rate or large trust companies could create mortgages by removing

some of these unattractive features to the mortgage which prevent new institutions from rapidly growing which would operate in both the primary and the secondary market.

I would foresee, for instance -- I don't know whether they would foresee this but I would foresee where some of our larger trust companies could very well have gone into N.H.A. mortgages and into which they could place short, medium and long-term paper. This is just another method of this mortgage.

COMMISSIONER BROWN: In other words, the trust company would be filling the same place somewhat as a building society?

MR. CAMPBELL: Yes, but this is just sort of an extension of our existing institutions, that perhaps these mortgage company institutions who would deal solely with these mortgages could be used until it was well established and had grown up enough to extent its whole operations into conventional mortgages.

COMMISSIONER BROWN: Can you give us any picture at the moment of what the demand is for housing? Is there a shortage of housing in Canada?

MR. CAMPBELL: I think there are an awful lot currently of unsold houses and vacant houses but again this has happened periodically and undoubtedly will continue to happen periodically. Even if we do accomplish the 10 years estimated average requirements and we have over 145,000 units per annum, in reaching that average we will have had periods when there tends to be housing shortages and tends to be surpluses and, of course, these are

geographic -- they tend to be geographic right now because mortgage money is available in Toronto where it is not available in Corner Brook, Newfoundland so that you do not have much of a suprlus of houses in Corner Brook whereas an investor is happy to take a mortgage in Toronto.

COMMISSIONER BROWN: You cannot give us the figure on what the total is?

MR. CAMPBELL: Total? No sir.

COMMISSIONER BROWN: Or a shortage or surplus?

MR. CAMPBELL: C.M.H.C., I think, publish a sheet on this almost weekly or daily.

COMMISSIONER LEMAN: You have just made reference here to this difficulty related to remote areas. How would you handle this particular problem otherwise than by keeping the C.M.H.C. as a direct lender?

MR. CAMPBELL: Well, I think there will always be special situations where C.M.H.C. or government in some function is necessary. Perhaps it is better that they loan the money to the banks on the condition that they will lend in remote areas on suitable terms instead of doing it themselves. But in this I do agree with the previous submission. If you can tend to have one mortgage be the same as the other in certain aspects of its investment character then it seems to me that the bank branch in a remote area, the manager, can follow a set of rules and service that mortgage there just as well as the manager up in North York can service a mortgage there and we would tend to overcome this geographic

discrimination that does exist and is a serious problem. This was the excuse for getting Central Mortgage going in such large volume. Then, we had a period of tight money and that covered other areas and now we have just got a big bad habit.

COMMISSIONER LEMAN: It seems to me when people talk about residential mortgage they seem to lose the propensity on which normal market forces operate. Isn't it possible in view of the gap you referred to and in view of the ambition that everybody has to create a system that will produce lower interest rates for residential houses that today we are being a little too ambitious?

MR. CAMPBELL: I think we are too ambitious if we try to accomplish it overnight and for this reason there is a certain amount of artificiality in the whole theory of the National Housing Act but in the long run I do not think there is anything unsensible about this.

COMMISSIONER MacKEEN: Mr. Campbell, when you said that mortgage money was not available in places like Corner Brook did you mean National Housing Act money or conventional?

MR. CAMPBELL: I mean mortgage money generally. There is a local market which I guess provides some but large institutions who do not have servicing agencies in the remote areas do not want to take these mortgages on because the servicing cost is too large. If Sun Life have a branch in Edmonton but not 70 miles north or 170 miles north of Edmonton they are pretty reluctant to go 170 miles north but my point is the banks have a branch

[illegible]

170 miles north of Edmonton and if we were to make full use of our facilities we would tend to end this geographic discrimination.

COMMISSIONER MacKEEN: Corner Brook is what might not be too good an illustration.

MR. CAMPBELL: I am sorry, I should not have mentioned any place. Perhaps I should have said Toronto and nobody could throw a stone.

COMMISSIONER LEMAN: Do you feel that a mortgage in Uranium City should attract the same rates as a mortgage on the outskirts of Toronto?

MR. CAMPBELL: Well, that is a double-barrelled question. You are dependent upon a Blind River situation obviously not because the servicing agencies that are involved here should take these risks in servicing and the investor should take these risks. Perhaps when you get a specialized company town situation you do get closer to what I foresee, a proper government function for assisting taking of risk but that is a different question than a remote area. I feel basically that remote area mortgages can be serviced as cheaply or almost as cheaply as urban area mortgages and that they can be made to be worth on the market the same amount of money without too much cost to the government, without too much addition to the contingent liability of insurance company funds etc. I think there is a good point to this trying to make one mortgage the same as the other within reason, within limitations.

THE CHAIRMAN: Yes, but in the more remote areas there is not the active market for real estate that there is in the more congested areas so that that

affects the value, doesn't it, of the mortgage?

MR. CAMPBELL: Mr. Chairman, yes it does but it also --

THE CHAIRMAN: It may be that the land is just as good and the people are just as credit-worthy but there is a big difference.

MR. CAMPBELL: It affects the amount of mortgage you can get there in the first place. It affects the whole character of the housing and has and will continue to do so unless we try to make something very artificial so that everybody can have a, say, $32,000 house.

THE CHAIRMAN: But N.H.A. mortgages are for houses built according to N.H.A. standards, are they not?

MR. CAMPBELL: Oh yes, but there is a broad price range of houses that can be purchased under the National Housing Act.

COMMISSIONER MAcKEEN: Mr. Campbell, would you suggest that in the outlying sections because there was a chartered bank branch there that the manager would be qualified as a banker in determining the value of a house for loaning purposes or servicing the loan after it has been made?

MR. CAMPBELL: No, I would not make that suggestion at all. If he happened to be he would certainly find himself in head office pretty rapidly. I do suggest, however, that he could follow a set of rules to administer a loan there and I also feel that there are mechanics available for the valuation of that house and the limiting of the size of the mortgage and what have you which do not depend

on his knowledge but depend on the knowledge of specialized expertise in mortgage finance and the manager in Head Office and his staff and depend on the expert people that we are really blessed with in C.M.H.C. who say:"This is the maximum amount of loan we will insure here". They have done a fine job.

COMMISSIONER MacKEEN: Do you think the actual officer concerned in making the loan should be a highly qualified individual?

MR. CAMPBELL: I think the individual person making the loan should be able to follow a set of rules for the making of loans and have normal expertise in the field of personal credit which all local bank managers have because you have a covenant in there which is very important in the mortgage. I feel it does not depend upon the local bank manager being qualified as a mortgage man.

COMMISSIONER GIBSON: Would you care to say a little more about why the market for N.H.A. mortgages is so inadequate? In your brief you say that only four of five institutions are continuing to take N.H.A. mortgages and lending real money. I take it at other times there have been quite a lot more and the amount has varied. Why is it there seems to be such loss of interest in N.H.A. mortgages?

MR. CAMPBELL: There was one aspect to this conversation we covered earlier where we talked about the attractiveness of mortgage funds as opposed to non-mortgage investments which I think affects the answer but specifically I think those

features which are unattractive and cause a mortgage investment officer in an institution to question the value of the value of the insurance obligation has had a large part to play.

Now, obviously I cannot name names but I have told you in my brief that one company used to make N.H.A. mortgage loans and it no longer does because it feels that the insurance obligation is not adequate, it is not -- I hesitate to say is not worth the paper it is written on but it does not mean enough to them to attract them in. To them there are too many things like that and so they do not make the mortgage loan.

COMMISSIONER GIBSON: You believe there is a fairly general feeling or quite a widespread feeling, let us say, in this direction - not as strong as that - but that there are quite a lot of institutions who buy mortgages, who are just not interested in N.H.A. mortgages?

MR: CAMPBELL: That is right, and there are quite a lot of institutions, at least a few institutions that do buy them perhaps recognize these defects that have a large volume of funds for investment and this is a convenient market. They have a sophisticated approach to mortgage matters and perhaps would be willing to make 85 per cent loans without insurance, and so they are willing to go into this. On the other hand, from my personal knowledge I know of fairly substantial amounts of money which have not found their way to this market because of these technical defects.

COMMISSIONER GIBSON: Of course in theory if conventional mortgages were popular and a lot of people would make and buy mortgages, you would think that after a while the rate on conventional mortgages would be down sufficiently so that the N.H.A. mortgages would become attractive. There would be some adjustment in the relative interest rate.

MR. CAMPBELL: This just happened quite recently.

COMMISSIONER GIBSON: Yes, but I take

it you still do not think that has nearly corrected the lack of interest in that kind of mortgage as an underlying problem.

MR. CAMPBELL: No, I think these things are bound to happen from time to time, but as far as any long range programme is concerned I think you have to have the unsophisticated investor completely protected.

Maybe I am going too far in that statement without saying what things I mean first. The unsophisticated investor should not have to rely on his own expertese in mortgage investments because he has none.

COMMISSIONER GIBSON: No, I understand this as to the unsophisticated investor, but I am just asking you about what the people that really know about mortgages, insurance companies, trust companies and so on, about their views. This is their business, they know about it, so I do not think you can talk about them as being unsophisticated in any way.

MR. CAMPBELL: Oh, no.

COMMISSIONER GIBSON: Well, they are not particularly interested, or a lot of them are not particularly interested, so you do not necessarily have to go so far as to make it interesting to the unsophisticated investor. Perhaps we could start by making it more interesting to the sophisticated investor.

MR. CAMPBELL: Well, a lot of the

sophisticated investors are under a misapprehension that it is far, far more complicated to get into and to administer an N.H.A. mortage than it really is, so right away they are in the unsophisticated class.

A lot of the sophisticated mortgage investors are prepared to make more than 66 per cent loans, and to make these, if they can find a means of doing it, on a grade A lease-back, they will choose this over, you know, 7¼ per cent over 15 individual houses or two small apartment buildings under the National Housing Act.

I think we get back to the point of competition here. Try to make our N.H.A. mortgage compete with other investment, even other mortgage investment situations. I am not answering your question, I know, really.

COMMISSIONER BROWN: Would that then make it more difficult for the others?

MR. CAMPBELL: I don't think I got the point of your question.

COMMISSIONER BROWN: You are now talking about N.H.A. mortgages, making them more acceptable, more competing with others.

MR. CAMPBELL: Yes.

COMMISSIONER BROWN: So that it would attract those people to buy, invest in N.H.A. mortgages instead of conventional. Would that not then make it more difficult for the con-

ventional?

MR. CAMPBELL: Yes, they are competing in the same money market generally, so it would tend to make it more difficult.

COMMISSIONER BROWN: For the conventional mortgage?

MR. CAMPBELL: Yes, but surely the whole function of the government insurance obligation attached to this mortgage should make it more desirable than conventional loans, so that this should follow. I mean, this would be a desirable thing.

COMMISSIONER BROWN: Then in effect they would be getting more N.H.A money by taking it away from conventional mortgages?

MR. CAMPBELL: I think that is an over-simplification.

COMMISSIONER BROWN: I am talking about the specific example you were discussing, with the unsophisticated and sophisticated.

MR. CAMPBELL: Yes, but I do think that to the extent that the mortgage department is going to allocate funds as between conventional and N.H.A. loans it certainly would tend to take it away from the conventional field, but I am inclined to think that the mortgage department might get more funds if this happens.

COMMISSIONER LEMAN: Mr. Campbell, perhaps I had missed part of what you have been telling us here. We are jumping about a little bit

in our questions. I would like to ask you a question that is a little bit more direct. We are talking about a large gap in funds available for a specific purpose.

MR. CAMPBELL: Yes.

COMMISSIONER LEMAN: Your brief deals with a lot of technical questions, and I think it is commendable that you would want to remove any technical obstacles in order to let the market forces work more smoothly, that is basically the approach.

MR. CAMPBELL: Yes.

COMMISSIONER LEMAN: What I would like to know is, suppose you did remove these technical difficulties, then from that one factor how much of the gap do you think you would close? Is it the result of having these disregarded market forces in the basic yield on this investment that has created the gap, or is it more in the technical. Is my question quite clear?

MR. CAMPBELL: Your question is quite clear. I hesitate to answer it because may be this is the whole reason I have this brief in and pick out these points, and I have in parenthesis what I am saying here, and I think the removal of those things, would strongly tend to close the gap.

I have had enough personal experience and commitments to feel that it could have from time to time in the past, and therefore it is very

likely to be able to accomplish this in the future.

I could go on and pick out foreclosure procedures in Alberta and 150 more little things that are wrong. This may appear technical but it really is basic, and certainly there are other markets forces at work, but you have to get out and compete for your money. Isn't this really basic?

COMMISSIONER LEMAN: Well, Mr. Brown was actually trying to get at what other gaps would you open up if you closed this one; that basically there may have been periods, there have been periods, in Canada when there was a gap in the total investment funds of the country.

MR. CAMPBELL: Right.

COMMISSIONER LEMAN: And to close a big one like this, might you not open others?

MR. CAMPBELL: Yes, but I started off by saying that 20 years ago we did not have much of a gap. We just, I think, started the Dominion Mortgage Act at that point. Maybe it is 25 years ago, but this gap has been widening and it is getting worse, and the mortgage market is getting singled out year after year after year, and it is sort of getting conventional, you know, to treat it the way it has been treated. I feel we should try to get back to the state where everybody is competing for the available supply of money, and not leave the housing industry out of it entirely.

COMMISSIONER LEMAN: About 20 years ago, if we did not have this gap as apparently it is today, we must have had a housing shortage by today's standards.

MR. CAMPBELL: Oh, yes, and I suppose for a long time to come, on some Utopian standard, we will always have a housing gap.

We should try, from the sociological aspect of the thing, realistically to prove what our requirement is and reach it. By removing the things which seem to have over the past many years, maybe 20, created this artificial gap, then at least the normal foces at work can compete. I can go and borrow $5,000 mortgage on my house for my mother-in-law or something, instead of having her put them in Hydro bonds.

Mortgages are tending to become a funny piece of paper that people no longer like.

COMMISSIONER BROWN: I think part of that is the fact that monthly payments are not always convenient for the private lender.

MR. CAMPBELL: Yes.

COMMISSIONER BROWN: And this is developing in this country because of the problem of monthly payments during the term of the mortgage which did not exist 25 years ago.

MR. CAMPBELL: Yes, and that is one of the new functions for existing financial institutions which I advocate, is that, being large, they can issue series paper or tailor or adjust any

pieces of paper out of the mortgage to fit various interest requirements.

COMMISSIONER BROWN: This brings up my next point that if this corporation is created and then issues this paper, this paper has to be issued in competition with your hydro bonds.

MR. CAMPBELL: Yes.

COMMISSIONER BROWN: Or Bell Telephone and other companies are also trying to compete for that type of money.

MR. CAMPBELL: Yes.

COMMISSIONER BROWN: What is going to fill the gap that is going to be created there?

MR. CAMPBELL: It is just going to re-establish competition in the whole market of all of the people who want money, instead of removing the housing outside of it.

COMMISSIONER GIBSON: Could we get at this more clearly by having your ideas as to what created this gap? How do we come to get this great gap in housing finance that everybody talks about?

MR. CAMPBELL: Well, one of the points has been raised, and that is the fact that we have for collection purposes, we have changed our mortgage repayments from half yearly and annually to monthly on blended payments for collection ease. So we now have an investment which is perhaps suitable for pension funds and life companies but perhaps not the rest of the

market.

COMMISSIONER GIBSON: There must be something more fundamental than that behind this thing.

MR. CAMPBELL: Sure, there are lots of things, I think, which are fundamental behind it. It is the difficulty in the expertese required in creating mortgages, knowing what you are doing, having confidence.

I think I said in my brief that investment dealers are excellent in selling bonds. It does not make them mortgage experts any more than it makes a bank manager a mortgage expert.

I say, difficulty in creating the mortgages. With so many dollars required for new construction, the investor is afraid because he is not a bricklayer or builder, and he is afraid to go into a new situation.

You have the fact that interest rates do vary on mortgages, they are a higher rate, and the uncertainty of the length of your investments as compared with competitive investments.

COMMISSIONER GIBSON: Well, all those things existed before. Do you subscribe to the theory that is quite frequently put out, that savings have tended over the last generation to become institutionalized, and that a lot of the mortgage financing used to be done by lawyers and so on and this does not happen very much and the

institutions are not yet ready to move fully into this. Is this a sensible view of the situation?

MR. CAMPBELL: Yes, this is not unusual that savings tended to become institutionalized but mortgage funds tend to go into the institutions instead of to mortgages because of a recognition of the expertese in making the loan as well. I mean, it is the combination of a number of factors. It has developed though.

THE CHAIRMAN: Can you give me any indication as to the extent to which mortgage business which, 20 or 30 years ago was carried on through solicitors' offices, has decreased? Do you know that?

MR. CAMPBELL: No, sir. I am 37.

THE CHAIRMAN: Well, the great backbone of many solicitors' offices at that time was the mortgage business which they transacted for clients who had small amounts of money and could put it out on mortgages, even if they were doing it through an institution. I wondered where that sort of money goes today? Has that sort of business been increasing with the increase of population and wealth or is it dying out?

MR. CAMPBELL: Well, this is not from personal experience, because we are pretty far removed from this, and besides, as I said, I am younger, so I do not have a lot of older, dead clients and estates. But I do know that a lot of funds still remain with lawyers for investment,

but lawyers in their investment approach have tended to become institutionalized too, and perhaps some of them have put funds, where they have the power to do so, in second mortgages or the odd first mortgage on the family homestead which is being sold, but more and more they tend to use the services of the investment dealers and not take the risks themselves of making a mortgage investment.

THE CHAIRMAN: So that a great deal of that money which used to come into mortgages, no doubt goes into something today but perhaps not mortgages, is that it?

MR. CAMPBELL: Yes, Hydro bonds.

COMMISSIONER LEMAN: Mr. Campbell, you seem irked by this gap and you ascribe a great deal of the reason for its existence to the technical field. Now, I would like to ask some questions in another form. Suppose that someone had tried to put a lot of money into the consumer durable goods market at 6½ per cent to the borrower in the last five years. Don't you think you would have created a big gap in that market too?

MR. CAMPBELL: Yes.

COMMISSIONER LEMAN: So I am wondering if it is not partly a disregard for market forces, besides the technical obstacles that has created the gap.

MR. CAMPBELL: Well, I am sure the market forces are partially responsible. The market forces are things which are different tomorrow than they

were yesterday, and these market forces about which we speak are things that have grown over a period of time.

I am suggesting that we try to amend them somewhat, and perhaps it is just as simple as some of these technical things, so that there is a general ability to compete for the available funds.

COMMISSIONER BROWN: Would an increase in rates accomplish it?

MR. CAMPBELL: I don't think so.

COMMISSIONER BROWN: Would an increase help to close that gap?

MR. CAMPBELL: That is a different question. Help to close the gap, yes, but an increase in rates, in my opinion, alone would not close the gap.

COMMISSIONER BROWN: Would it make them more competitive in this competitive market?

MR. CAMPBELL: Well, we start now to go around in a circle. I think that an increase in rates would help to close the gap, and people would make the investments, but they would shy away from making too many because the loans are prepayable and they would lose their good investment in favour of some other longer term investment available at slightly less rates.

COMMISSIONER GIBSON: I ask you one of your own questions. Is a free interest rate on N.H.A. mortgages feasible? Would you comment on

MR. CAMPBELL: I feel that it is most desirable, but that it is only feasible if there is a large volume of capital available to compete for investment in N.H.A. mortgages.

I think it is something that could be accomplished rather rapidly. The effective results of the system obtaining under the F.H.A. for mortgages in the United States is the free interest rates, and this tends to make more mortgage money available in the United States than is available in Canada. It does not overcome the whole problem, but it certainly tends to, and this is most desirable, to have the market sensitive to interest rates, and I think, in my opinion, that the N.H.A. mortgage rate should be free just immediately upon the private capital market furnishing the N.H.A. requirements in any given short period of time.

COMMISSIONER GIBSON: You don't think this would tend to cost the people benefitting from N.H.A. mortgages any more than the present system?

MR. CAMPBELL: There would be bound to be initial and from time to time minor dislocations, but in the long run it would save them money, not cost them money.

COMMISSIONER LEMAN: As an example of the stickiness of rates, etc., in that field, would you visualize or even recommend, for instance, the C.M.H.C. selling mortgages at 94 -- at a discount?

MR. CAMPBELL: Well, I don't think C.M.H.C. should have as many mortgages to start with to be selling, and government selling at a discount without the intention to re-invest and upgrade their portfolio is different from a bank or life company doing the same thing. Perhaps it is the function of government to subsidize the housing industry in this indirect way of taking losses on their mortgage investments.

I don't think they should be re-investing to protect their yield. I think they should be performing their function of -- well, the function we have grown to expect from them as being one of the main assists in our socialogical requirements.

COMMISSIONER LEMAN: You would not go further than just to say "perhaps"?

MR. CAMPBELL: Sure, I think they should.

COMMISSIONER LEMAN: You think they should?

MR. CAMPBELL: Yes. I think they should still get the best price obtainable at any time.

COMMISSIONER LEMAN: This has not been done yet, has it?

MR.CAMPBELL: I think they have been very careful in the way they have been marketing their mortgages, and they haven't exposed themselves to this criticism which would be bound to flow in on them.

COMMISSIONER LEMAN: Is that another field of unsophistication?

MR. CAMPBELL: On the part of the people that criticize.

THE CHAIRMAN: There are no further questions? I wish to thank you very much for your presentation, Mr. Campbell; we are very much interested.

MR. CAMPBELL: Thank you for the opportunity, Mr. Chairman.

THE CHAIRMAN: We shall now adjourn until 2.15 P.M.

--- Luncheon Adjournment.

--- On resuming at 2.15 P.M.

THE CHAIRMAN: The Commission will now resume: Urban Development Institute; Mr.MacDonald?

SUBMISSION OF URBAN DEVELOPMENT INSTITUTE
ONTARIO DIVISION

APPEARANCES

Mr. Alan J. Scott	-	Past President
Mr. D.G. MacDonald	-	President
Mr. H.K. Morley	-	Vice-President
Mr. Alec K. Dixon	-	Executive Director

MR. MacDONALD: Mr. Chairman and members of the Commission, in my opening remarks I would like to thank the Commission for the opportunity of appearing here today and presenting our views. I would like also to give you a very quick run-down as to what the Urban Development Institute is.

The Urban Development Institute (Ontario Division) is an association of active land developers in the Province of Ontario. The institute was formed in 1957 in recognition of the fact that the providing of land for housing at a price within the means of the average person, has become a serious social problem. One of the major difficulties in the solution of this problem has been the lack of a single recognized channel of communication between land developers and municipal and other levels of government so as to permit greater understanding and cooperation in mutual problems.

In order to be more representative of firms and companies engaged in land development in Ontario, the Institute accepts as associate members certain selected firms in the fields of subdivision engineering and town planning. The Institute is thus able to speak with a single voice in the interest of better understanding with the various levels of government, to ensure closer cooperation in all matters affecting land development.

Statement of Policy: In march of 1960 the Urban Development Institute (Ontario Division) received its Provincial Charter as a non-profit organization, having the following aims and objectives:

(1) to promote well planned communities by encouraging the reasonable and economic use of land.

(2) to promote efficiency and a high standard of ethics among persons and corporations engaged in land assembly and development.

(3) to promote understanding and co-operation between persons and corporations engaged in land assembly and development, and municipal planning, and other government authorities and agencies.

(4) to promote the availability of building lots at the lowest possible cost.

(5) to promote revisions in the tax structure so that land alone would not be required to produce the revenue necessary for educational and social services.

Now, a brief definition of a land developer: A land developer is a person or individual who buys land and manufactures building lots. He invests his money in the land and sewers, water and

various services and markets a commodity in the market.

Mr. Chairman, on page 1 of our submission, Item No. 2, we have a summary of our recommendations, five in number. With your permission, Mr. Chairman, I would like, before going into these five recommendations, to say that if you have had an opportunity to study these recommendations it must have occurred to the members of the Commission that there is a very basic recommendation which is longer term in nature which does not appear here. This, we presume, will be stressed very strongly by the representatives of the municipalities which appear before you, and this is the necessity for an immediate beginning of a detailed study on revision of the tax structure in Canada.

THE CHAIRMAN: Well, of course, we are not concerned with that so much in this Commission. I think you will have to confine yourself to your brief. We have read the brief, and if there is any material that should have been put in it, it should have been before us so that we would have had a chance to consider it. I would suggest you continue with the brief and then leave it open to us to ask questions.

MR. MacDONALD: Mr. Chairman, that is my intention. I was not going to proceed any further with this particular point, and if there are any questions we will be prepared to develop them later.

THE CHAIRMAN: It may be that some members may decide to ask questions on that point.

MR. MacDONALD: Thank you, sir. Our five recommendations appearing in this brief, Mr. Chairman,

break down into two sections. By reason of the fact that our membership is basically land developers, but also includes land developers and builders, you will note that recommendations 1, 2 and 3 refer to N.H.A. loans and mortgages in general, whilst recommendations 4 and 5 have a more direct connection with land development.

Recommendation No.1: "That the down payment for N.H.A. loans be reduced through an increase in the maxima by regulation and an increase in the percentage of loan to lending value. Similarly, a further change in the Insurance Act should be made to permit conventional mortgages in excess of the current 66-2/3 per cent of lending value.

We realize on this particular point there are dangers in going to extremes both in the amount of these loans and the term, but particularly we feel very strongly in regard to the increasingly present maximum of 66-2/3 per cent on conventional mortgages.

Recommendation No. 2: "That to reduce the carrying charges on N.H.A. loans, consideration should be given to an effective extension in the amortization period."

I would like to emphasize the word "effective". At the moment I believe the maximum term under the National Housing Act is 30 years, but this is not an effective term because many of the mortgage companies -- I think the majority -- do not write their mortgages to the maximum term of 30 years.

Recommendation No. 3: "That the Bank Act be amended if necessary to permit the chartered

banks to participate directly in N.H.A. lending activity without regard to the current 6 per cent interest limit."

We do not know, first of all, if the Bank Act has to be amended. If it is not a requirement, or if the Bank Act was amended, we do not know how much N.H.A. lending would come out of this, but at least the opportunity is there.

Recommendation No. 4: "That municipalities be permitted to borrow capital funds through the National Housing Act in order to install other municipal services in addition to trunk sewers and sewage disposal plants, on a local improvement basis repayable through taxes."

The legislation was passed under the National Housing Act approximately two years ago providing for N.H.A. financing of trunk sewers and sewage disposal plants at the N.H.A. rate of interest but with the remission of 25 per cent of the work completed before March, 1963. We are suggesting this could be extended to include auxiliary sewers.

Recommendation No.5: That consistent long-term federal government policies with respect to the financing of land development and housing be devised so as to ensure a healthy and continuing investment climate." Thank you.

COMMISSIONER LEMAN: Mr. MacDonald, in your statement of policy -- or, at least in your Appendix A, you say that the providing of land for housing at a price within the means of the average person has become a serious social problem.

When did it become so? Is this a recent worsening of the situation, or is it a long-term view you have taken.

MR. MacDONALD: This is relatively long-term; I would say over the past eight years, Mr. Leman. I would say about eight years ago the Subdivision agreement -- what is commonly termed the subdivision agreement in the trade -- came into effect. Before this came into effect municipal services such as sewers, water, roadways etc., were installed under the Local Improvement Act by the municipalities. Because of the problems which the municipalities began to feel eight or ten years ago with the mushrooming growth and the resources they had to meet these problems, the policy was changed. It began in Toronto and spread throughout Ontario, and then Canada, whereby the developer put in at his own cost all these internal services -- sewer, water, roadways, etc., and of course these costs were passed on to the house purchaser. You will say that whether the developer did it or the municipality did it, the cost was nevertheless there. That is true. There are two points involved here: When the municipality did it under the Local Improvement Act approximately 25 per cent of the cost of this was carried by the general taxes, and 75 per cent applicable to the abutting property. In other words, the Municipal Act envisaged that there was a benefit to the whole community to the extent of 25 per cent of the total cost of the expansion of the community. When the Subdivision Agreement came into effect the home owner carried 100 per cent of the cost of all these services.

There is another point that comes into

this now: When the municipality brought this Subdivision Agreement into effect whereby the developer, and hence the house purchaser, was paying these services in total, the municipality was still in the position of dictating what services and what standard of services would go in. When this developed you lost the checks and balances system that you had in the past whereby the engineering department had to satisfy the treasury department as to what monies were being expended, and we contend that it is human nature that when you have an engineering department or a municipality that is not paying any of the cost of this, or do not have to find the money for these services, that the tendency is -- put it conversely: There is no great pressure to keep this to a reasonable minimum, and this is another point I say has increased costs. The standards have gone up of servicing land. I would say there are two points: No longer does the general tax rate carry 25 per cent of the cost of servicing these properties, and secondly, engineering standards have risen considerably.

COMMISSIONER LEMAN: But under the old system didn't some municipalities get caught with extension of services that had been ill-timed?

MR. MacDONALD: I would agree that has happened, very definitely. We have a subdivision in Hamilton developed in 1912 that has just been built upon in the last two or three years.

COMMISSIONER LEMAN: So there was a reason for this basis of doing things?

Mr. MAcDONALD: There was a reason, very definitely: It is the economic problems of the municipality, Mr. Leman.

COMMISSIONER LEMAN: To deal directly with the first recommendation you make, in that field due to the National Housing Act there has been an improvement over what it was before: The amount of down-payment that people have to put down, and the price of houses -- in effect, you are saying it has not gone far enough; is that it?

MR. MacDONALD: That is right, sir.

COMMISSIONER LEMAN: By the way, is the maximum 30 years, or is it 35 years?

MR. MacDONALD: It is 35. I said 30, and I was corrected by my colleague.

COMMISSIONER BROWN: On the basis of 35 years now, how long extension would you have to have in order to get any effective reduction in the carrying charges?

MR. MacDONALD: In the wording of that recommendation, sir, I think we say that to reduce the carrying charges of N.H.A. loans, consideration should be given to an effective extension. How this is done, I don't know.

COMMISSIONER BROWN: You must have looked at amortization tables of some kind to come up with this recommendation: How effective a reduction do you want -- how long a period would it be necessary to get the extension for to get that reduction?

MR. MacDONALD: What I am trying to say is that we are quite happy with the 35 years if it is effective, but the private mortgage companies

in the main -- I would venture to say that 80 per cent of the mortgage loans are made on 25 years rather than 35.

COMMISSIONER BROWN: This must be the pressures of the market, then.

MR. MacDONALD: It very well could be, but we are quite happy with 35 years.

THE CHAIRMAN: Perhaps the mortgage companies are right to cut it down to 25 years. Why do you think that it should be 35? What is the advantage of 35? It means that the average monthly payment is a little bit less but not so very much less.

MR. MacDONALD: I do not have the tables with me, Mr. Chairman, but I would say this, and that is, that public housing and limited dividend loans are amortized up to 40 and in some cases up to 50 years by the federal government.

THE CHAIRMAN: Isn't it better for the person to own his house at the earliest possible moment instead of dragging it out and the difference between the monthly payments on the one basis is very little from the other? You will find that it is ~~a~~ very little difference.

MR. MORLEY: At that particular level of income it may bring in a very large number of people. A very large proportion of wage earners are in that bracket and to lengthen the term of the mortgage reduces the monthly payments sufficiently to induce a very considerable number of buyers.

THE CHAIRMAN: Have you any figures?

MR. MORLEY: I am afraid we have not.

THE CHAIRMAN: Take a sample house at so many thousand dollars, where does it work out? What is the difference, the sort of house that

might be bought by the average working man? Perhaps someone could work that out while we continue with the discussion to save time.

MR. MORLEY: We really represent the land development industry. This is getting into the house building field which, of course, is of very real interest to us but we do not have that kind of figure available.

THE CHAIRMAN: But you are proposing that the term of payments should be extended. That is one of your points and I am not so sure that this is a sound point myself.

COMMISSIONER LEMAN: Mr. MacDonald, have you answered the Chairman's question?

MR. MacDONALD: Well, we do not have figures. He has aksed for figures and we do not have them at the moment.

COMMISSIONER LEMAN: Do you have any evidence (still within recommendation number one) - do you have any evidence that the insurance companies would want a lower down payment and higher than 66 and two-thirds per cent mortgage on conventional business?

MR. MacDONALD: The evidence which I have is purely personal, sir, but in talking with officials of various mortgage companies I have a strong indication that in many cases they would go beyond the 66 and two-thirds per cent.

THE CHAIRMAN: Well, they do not go to the limit now in most cases, do they?

MR. SCOTT: Well, sir, if I may add to that, in certain areas it would seem that the appraisals on homes are over-appraised so that they can stretch this as far as possible in certain areas. It would also seem that if this were increased it would cut out some of the less satisfactory second mortgages and it would also seem that the older housing where a family would like to move into more quickly they could more easily move into older housing whereas at the present time they are forced through economic circumstances to move a long way out and to take the lowest down payment under the N.H.A. scheme which would allow a ten per cent down payment and this may lead to an urban sprawl because of the lower cost when one gets further out of the metropolitan area.

COMMISSIONER LEMAN: There is a question of leading a horse to water and making it drink. Those are two different problems. You point out too that on the 35 year effective amortization period you find that they do not go to the 35, those lending on N.H.A. lands and now what we are asking you here is - we are not arguing about the desirability of doing it but evidence that the insurance companies would want to go further. Is there evidence?

MR. MORLEY: I think there is very little evidence but that is the case. There is United States money being lent in Canada now up

to 75 per cent. I am not familiar with the reasons for this but I know in general terms that it is permissible under the United States legislation and it is actively being loaned now and that other companies who are only allowed to loan up to 66 and two-thirds per cent have expressed, privately anyway, the wish that they could go that far and I think as someone else said by higher appraisals this effect is being achieved.

COMMISSIONER BROWN: Presumably if this is so we will be having representations from these people.

MR. MORLEY: I would have thought so.

COMMISSIONER BROWN: They are the ones to make the representations.

MR. MORLEY: It could be so.

COMMISSIONER BROWN: Going back to this first recommendation again:

> "THAT the down payment for N.H.A. loans be reduced through an increase in the maxima by regulation and an increase in the percentage of loan to lending value."

What sort of figures are we talking about? How far do you want to go? You want an increase from the present. How big an increase are you thinking in terms of?

MR. MacDONALD: The present maximum, I think, is 14.8 on a three bedroom house.

MR. MORLEY: I think it is possibly easier to think of this from the point of view of the down payment particularly in the metropolitan areas. It is extremely difficult to produce a house today in a metropolitan area such as Toronto on fully serviced land requiring a down payment as low as $3,000. It is extremely difficult, a detached house. It is more normal for $4,000 to be called for.

COMMISSIONER BROWN: How expensive a house is this?

MR. MORLEY: Say $17,000 - $17,000 or $18,000 and it would seem more desirable to approach 15 per cent equity than as it often is, 20 or 25 per cent.

COMMISSIONER BROWN: You do not think that somebody who is building that expensive a house should not be able to pay down more than 15 per cent?

MR. MORLEY: It is very nice if it can be done but normally there are so many other attractions for using that money before it is saved up.

THE CHAIRMAN: I suppose there are not many new houses you can buy for less than $17,000 in the Toronto area?

MR. MORLEY: No, there are very few.

THE CHAIRMAN: Is that so?

MR. MORLEY: Yes.

COMMISSIONER LEMAN: Do you think there

might be a danger that with all these so-called improvements for the house owner you would end up by making house ownership over a period cheaper than renting the same accommodation by causing the borrower to have such a low equity or building up an equity in his house so slowly that you would run into irresponsible behaviour? Isn't there a little evidence that you can run into this? I think in the States they may have had some indication that there are practical limits. If you go beyond those limits you do run into such behaviour.

MR. MORLEY: Yes, I would agree there is a danger but at present we are a long way from it in the urban area. We are getting back 20, 25, 30 per cent or even 33 and a third per cent in the case of a conventional loan and that is we would think sufficiently safe to allow of reduction and it reduces the danger of the second mortgage method of financing which is much more vicious.

COMMISSIONER LEMAN: I was referring mainly to the N.H.A.

MR. MORLEY: Even second mortgages enter into the N.H.A. operations.

COMMISSIONER LEMAN: Then that comes back to Mr. Brown's question, what are the limits you would recommend of both types?

MR. MORLEY: I would think that it is too complex to give a categorical answer on this

[illegible]

because there are so many factors involved by virtue of different locations and values but I would in general terms say that a 15 per cent equity should be adequate and should be aimed at.

THE CHAIRMAN: What percentage was that?

MR. MORLEY: 15 per cent.

THE CHAIRMAN: Well, one of the difficulties is that you reduce now the equity and then the prices go up. Very often they tend to rise as the result of that?

MR. MacDONALD: That would be so if there were only first mortgage financing but I think what more often happens is that a second mortgage is entered into and the purchaser may only put ten per cent equity in and may borrow 66 per cent by first mortgage and the balance by second mortgage which is much more expensive and much more onerous. We do not suggest that this is a simple problem.

THE CHAIRMAN: Well, the N.H.A. has already made a reduction some time ago and I suppose now the spread is greater because of higher costs in building houses?

MR. SCOTT: Perhaps it is not a case of building houses that is the trouble here so much as the provision of the land for them with the additional funds.

THE CHAIRMAN: Well, I would add that, yes.

COMMISSIONER BROWN: If there is a greater demand for these houses by making it easier for people to buy then there would be more competition for the land and the price of land certainly does not get any cheaper under those circumstances.

MR. SCOTT: This depends upon what trunk servicing had been carried out by municipalities to ensure there was not a monopoly in one area.

COMMISSIONER BROWN: Then the costs of service would go up?

MR. SCOTT: The cost of servicing necessarily must come in advance of development of the land and in many cases it has been left to the developers to do this rather than traditionally by the municipalities over the last few years and this recent change in the N.H.A. which has made moneys available to the municipalities has been a great help in stabilizing the cost of raw land.

COMMISSIONER BROWN: In Appendix B that you have, is a copy of a resolution, and I was wondering if you could clarify it for us. The resolution reads after a lot of "whereases":

"THEREFORE BE IT RESOLVED:

(a) The sale of Federal-Provincial land by public tender, auction or some other basis calculated to result in a proportion, at least, of the profit involved in these operations being realized, would result

"in sufficient funds accruing to the Federal Government to finance the proposed installation of trunk services in the municipality in which the Federal-Provincial Land Assembly has taken place."

Now, at first reading that sounds as though you recommend selling these lands by auction because thereby you get a higher price for it or the government would get a higher price for it and this profit would be available for other land. This sounds a little contradictory because it sounds as though you are trying to get a higher price for the land in order to get land cheaper?

MR. SCOTT: There have been acquisitions of land principally, I think, in 1954 in this province by the Federal-Provincial Partnership and these lands, except in a few locations, have remained undeveloped either because one of the two partners or the municipality has not wished to go ahead with that development. There has been no demand for it and at the time of this resolution which was presented to the Minister of Works - and I believe this had some bearing on the provision of funds for trunk services - we were looking for a place to say to him: "If you sell these lands then you can build trunk services, the trunk services which would keep raw land prices down which was the object of putting together this Federal-Provincial Land

Assembly scheme. But then you sell this off and you would expect trunk service, sell it at the highest price and then the municipality might spend the money in various trunk services and we will proceed and the inter-governmental differences may thereby be resolved."

MR. MacDONALD: I think, to add to Mr. Scott's remarks, that it is our feeling that like any other commodity the more stock you have on the shelf the lower the price will be and the greater the competition. And we think the greatest factor in keeping land prices down is the presence of trunk sewers; in other words, there is serviceable land available and it is on the shelf, so to speak, and more competition is developed. The reverse situation is where one developer builds his own trunk service and one developer has the cash to extend the trunk service to his own piece of land and he has a monopoly and you lose all competition.

COMMISSIONER LEMAN: Isn't what you have just described the mechanism which tends to raise raw land as well as serviced lands?

MR. SCOTT: That is right, sir.

THE CHAIRMAN: I don't know whether I quite understand it or not but is the effect of what you say that if trunk sewers are put in over the whole area where the land is undeveloped then each lot in that whole area will be less expensive because there is not a small monopoly of

trunk sewered land in one portion of the area?

MR. MacDONALD: We say extended within reasonable limits.

THE CHAIRMAN: Yes, but there should be laid out a development looking ahead perhaps for a considerable time when the trunk sewers are installed but otherwise if it is developed piecemeal you have to put in a trunk sewer here and a trunk sewer there and it may be developing a problem and be more expensive. And the other effect of it, as I understand you, is that if the trunk sewer is only put into a small section to begin with that puts that developer into a sort of monopoly position as the owner of trunk sewered land. On the other hand, if another developer wanted to develop property next door he could put in a trunk sewer of his own, I suppose.

MR. SCOTT: This would appear on the face of it - this is true generally but you have certain limits to where your sewage plant is and where your trunks come out. You get to a point where because of the --

THE CHAIRMAN: Well, I think I see the point. I can see the value of that.

MR. SCOTT: This would also, sir, apply if one could extend that type of policy to other services which would benefit the municipality. I don't know if it is in order for me to expand on the fourth item, sir, because that

is the one where we talk about the trunk sewers, sewage disposal plants, etcetera.

THE CHAIRMAN: Now, they can borrow for trunk sewers only, is that right?

MR. SCOTT: That is correct, sir. Through the N.H.A. they may borrow for trunk sewers and this has helped very considerably because they are able to borrow at a better rate than they would otherwise be and they can then keep ahead with services. Now, if it were possible to extend these other municipal services then the municipalities would have overcome certain of these major problems of expansion that they have.

This extends particularly, of course, to their main expense today being in education and that is taking so much of their budget that anything that will help any other phase is extremely helpful.

COMMISSIONER LEMAN: Mr. MacDonald, in your paragraph eight in your brief there seems to be a hint there that you would like the flow of funds for residential construction to be insulated from monetary policy. Is that really your suggestion?

MR. MacDONALD: To the extent yes, that the housing business - and by that I include the development business to some extent - has been an economic tool, I guess is the best word, used by the government as an economic tool. This creates a situation whereby builders find it very

difficult to plan ahead, developers find it very difficult to plan ahead. You have a very fluctuating mortgage situation. At the present time most companies have money coming out their ears, to use the vernacular. By this time next year the situation may be reversed and if we are going to make progress in housing I think the progress is going to be in the field of industrialization and until this problem is overcome it is very difficult for builders to make much capital investment in order to improve methods of building houses and take advantage of industrialization generally.

COMMISSIONER LEMAN: On the other hand, Mr. MacDonald, what would you say is the present situation? Is there a shortage of housing or is there a little bit of over-capacity right now?

MR. MacDONALD: I would say at the moment there is a bit of over-capacity as of today. I will qualify that by saying in a price bracket over and above $17, $18,000.

COMMISSIONER LEMAN: Do you subscribe to the opinion of certain people to the effect that construction is one of the biggest factors in the cycle in creating demand for goods and services?

MR. MacDONALD: I would certainly subscribe to that.

COMMISSIONER LEMAN: Therefore is it not a little bit dangerous to say "let us insulate it from the effects of monetary policy" if it is such a large factor in the whole?

MR. MacDONALD: I would answer your question by saying that it is a matter of degree. I think we would like to see it less exposed than it is at the moment and has been over the last 15 years.

COMMISSIONER BROWN: Everyone wants that.

THE CHAIRMAN: Is not one of your problems then that in certain times there is a very great demand for housing, and there are a great deal of

houses built -- some of them are not too well built in those periods -- and then there is a temporary over-supply, and that all contributes to the cycle, it contributes to the situation which leads to some brakes being applied by the central bank? On the other hand, could you suggest or recommend that something be done to reduce the number of houses built during the boom period so that there would be an even supply of houses being built gradually, perhaps more from year to year as the population increases. Is that a practicable possibility at all?

MR. SCOTT: Sir, I think that the effect of the sudden placing of direct mortgages when there is a period of unemployment, does not necessarily coincide with the need for that extra amount of housing.

The location of this housing that appears with direct N.H.A. loans when they are suddenly placed in large quantities, is not always the best for the industry as a whole or for the planning as a whole, because they tend to go in very outlying areas, a large proportion of them, that is.

COMMISSIONER LEMAN: How would you go about trying to regulate the whole situation?

MR. SCOTT: We are just trying to point out some of the problems that are there. The solution is not as simple as all that.

THE CHAIRMAN: We would like to have

recommendations from those people who are in the business and are presumed to know.

MR. MORLEY: We would rather have the decisions taken by those that are affected, the mortgage lenders as they see the market and the builders themselves.

MR. MacDONALD: Just as an illustration, Mr. Chairman, of Mr. Scott's point, I do not like to localize things but I will go back to the City of Hamilton where I think about three years ago there was a great amount of money put out by the C.M.H.C. in the form of direct loans. One particular subdivision where one of the mortgage companies that we deal with have about ten lots in the subdivision of 50 lots, they have something like eight houses unsold, and the remaining 40 lots were entirely built up under direct loans from the Federal Government through C.M.H.C., and the mortgage company involved, with its eight unsold houses, their difficulties were increased eightfold or whatever the proportion is.

COMMISSIONER LEMAN: Are you suggesting that for a private builder to go into an area where another builder has made inroads to a great extent is a dangerous proposition, that he should not work in the same area?

MR. MacDONALD: Basically I think it could be summed up by saying - and I think this is the consensus of this Institute - that government

is best out of the direct loan field, except for outlying areas which are not serviced by the recognized lending institutions; because they come in and they disturb the normal market working and create periods of great surplus.

COMMISSIONER MACKINTOSH: Then really what you want is to let the cycle take its course?

MR. MacDONALD: That is right.

THE CHAIRMAN: By reducing the down payments are you not interfering with the effective operation of the cycle?

MR. MORLEY: By increasing it we are intefering with the cycle?

THE CHAIRMAN: By decreasing the down payment.

MR. MORLEY: I would suggest by not decreasing we are interfering.

THE CHAIRMAN: Well, I suppose the time always comes when the market is exhausted, and perhaps if you reduce the down payments it might extend the time a little bit, but that is about all.

MR. SCOTT: Sir, it becomes a question of where a family earning a certain salary is going to live, and whether it can afford to move into the areas under the present conditions. I am afraid that we are referring largely to the metropolitan areas where this problem exists.

They either go into the older homes where

they must have a first morgage which can only go to 66 and two-thirds per cent and then make such secondary arrangements as they can, or they have to go into the outlying areas with the minimum as it is at the present time, the minimums becoming very high in these metropolitan areas.

That is why we are suggesting that there is a large population which is not covered, does not have the opportunity to move into single family homes.

MR. MacDONALD: On that very point, Mr. Chairman, I would just like to enlarge upon it and say that I am on the Urban Renewal Committee in the City of Hamilton, and we feel thatin connection with this increase of the 66 and two-thirds per cent conventional loans, that a lot of the work which our body is presently doing on the selected area in the City of Hamilton could not be done otherwise than this particular area, because once an area is designated there is a blight put on it; but in adjacent areas which may be declared urban renewal areas with a lot of subsidies in the nature of write-down of land values which amounts to 50 to 80 per cent of land values on the average, could be avoided by the development of reasonably high conventional mortgages and N.H.A. mortgages on used homes.

I think this would offset, would bring about a situation where redevelopment could occur through private interests and avoid

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the great subsidies which are presently going into this urban renewal.

COMMISSIONER BROWN: Are you not in fact saying that when money is made more available, the price of housing is going up?

MR. MacDONALD: What I am saying, I am drawing the analogy, I would like to draw the analogy, Mr. Brown, of the used car market. If the facilities were not available as they are and have been for some time, for a professional automobile dealer, the man in the profession, to take in a used car, refurbish it and resell it to the public, I think human nature is such that we would see a great deal more wrecks travelling the road today.

I apply this to the housing field, that if N.H.A. loans were available on used homes, first of all you would avoid all this urban sprawl which we have today, because people have to go to the exterior and the periphery of the community to buy houses with low down payments; secondly the builder would be able to take these houses on trade, refurbish them and at that stage when they are about up to C.M.H.C. standards, he gets an N.H.A. loan. I think this would do much to remedy the deterioration that is taking place in our cities.

The question that is thrown back at you in that connection sometimes is that there is a shortage of mortgage money and where is this

money going to come from for these loans? I think the answer to that to some extent is that if the subsidies which the government at various levels are putting into this thing, which I say averages 50 to 80 per cent of the value of the land, if this money were left with the taxpayer by the normal cycle it would be invested back by the public in the form of mortgages.

COMMISSIONER GIBSON: And the reason this does not happen on conventional mortgages is the 66 and two-thirds per cent restriction?

MR. MacDONALD: Yes, that is a big factor and I think, Mr. Gibson, that to get this thing rolling in these areas, because of this situation existing now, and these areas have deteriorated to some extent, that it is going to take N.H.A. backing to get the companies, private lending institutions started making reasonable loans in there, and I think once they get started and see these areas develop they will be into conventional loans too.

THE CHAIRMAN: Further questions? Thank you very much, gentlemen.

SUBMISSION OF THE SECURITY ANALYSTS' ASSOCIATION OF TORONTO

APPEARANCES:

Paul S. Deacon	- President
Leonard E. Barlow	- Vice-President
Philip W. Speller	- Secretary
J. B. Purdy	- Treasurer
D. Stanley	- Past President
C. W. Goldring	- Director.

MR. DEACON: The Security Analysts' Association of Toronto is one of 28 member societies of the Financial Analysts Federation. Two of these are in Canada and the rest in the United States. Among the Federation's main functions is one described in the constitution as follows: "To work toward improvement in the quality and quantity of financial information disseminated by corporations; to make and publish surveys and studies with recommendations for improvement of corporate financial reporting."

Analysts are interested in promoting better information for several reasons. Two of the most important are:

Adequate information is essential to assess companies and industries and hence their securities. If investors are forced to appraise values on the basis of inadequate information, they

are more likely to make bad decisions and to lose confidence in investing.

Good information, widely disseminated, promotes broader interest in a security. As more investors become interested in a stock or bond, it becomes much easier to buy or sell that security, and both buyer and seller can have more confidence that the price is fair. Development of broader and more dependable markets for securities makes it easier to finance projects in Canada and to promote still wider ownership of existing companies.

Our Association considers the existence of adequate corporate information to be of concern to this Commission because broader ownership of securities by Canadian individuals and instituions is vital to the development of Canada's business and industrial life on a sound basis.

The provisions of the federal and provincial companies Acts which set the minimum standards for much of the information now available on Canadian companies, were written, in the main, to protect minority owners from the abuses that might result from the actions of the controlling shareholders.

Our purpose is much broader. We do not quarrel with the right of the majority to rule. We suggest, however, that management and the controlling shareholders consider minority shareholders as partners and provide them with informa-

tion that will allow them to be intelligently informed about their company's affairs. Because this information is made public to shareholders, it should also be made available to all investors so that a more accurate appraisal of the company's securities can be made.

We commend the Investment Dealers' Association of Canada and the stock exchanges for their endeavours to secure better standards of information.

Many companies, through enlightened self-interest, are voluntarily going far beyond the legal minimums, by providing better and more frequent information on their affairs. However, we believe that some compulsion may be needed to bring other companies up to adequate standards.

We propose to discuss the present state of information on publicly-owned companies under the following headings:

1. Annual Reports.
2. Interim reports.
3. Proxy information.
4. Prospectus information.
5. Jurisdictional problems.

In this brief, we cannot go into detail on all the aspects of the problem. However, here are some of the recommendations to which we wish to draw special attention.

I would just like to make one other mention about our group. We are made up really

of people working on securities on both buying and selling side, from banks, institutions such as insurance companies and investment houses, that type. There is a fairly wide group of individuals working on security analysis in our group.

COMMISSIONER LEMAN: Mr. Deacon, of the things you would like to see bring about this better standard of reporting how much do you think has the Stock Exchange put into force themselves alone for listed shares?

MR. DEACON: I can only go by the experience in the United States, perhaps, where the top exchange back in 1926 -- I think at that time they had something like 35 or 40 per cent providing an interim report. They sent out a letter requesting that the companies try to provide this. They started to put some teeth in it by the early 30's when all the investigations into the market were going on. They finally got to the stage by saying that new listings by a company -- a condition would be that they provide interim reports. So that now, I think, 96 per cent provide information. There are only 1 per cent, or less than 1 per cent who don't provide it, and some provide it quarterly and some on a semi-annual basis. So, in this instance at least the stock exchange has been able to bring this in in an effective way. It has not extended too far beyond that, but the top New York exchange has achieved this.

COMMISSIONER LEMAN: But if a stock exchange wanted to do it, they could do it, couldn't they?

MR. DEACON: Yes, I believe they should be able to do it on the basis -- they have started a procedure here, but so far have not made much progress.

COMMISSIONER LEMAN: Do the stock exchanges basically agree with all that you feel is the required minimum for good standards?

MR. DEACON: I don't know; I can't answer for them. I think they generally agree that

interim information is desirable. So far they haven't apparently felt that they can push it any further than that.

COMMISSIONER LEMAN: In paragraph 6 at the beginning of the summary you say:

> "We commend the Investment Dealers' Association of Canada and the stock exchanges for their endeavours to secure better standards of information."

You commended them, but would you commend them even more if they got together and said, "We are going to have these standards and that is all"?

MR. DEACON: Yes, I think we would. I think they have got -- they have started and done something that helped improve it, but so far I think we would feel they haven't gone far enough.

COMMISSIONER LEMAN: I am really leading up to my questions; these are interim questions: Would you plump right down for an S.E.C. in Canada?

MR. DEACON: No, I think not. In fact, I think our brief explains this a bit. We think we would like to avoid a bureaucracy where everybody has to file every piece of information with these people and have it looked over. The experience in Washington, the S.E.C. has done some wonderful things for the information available from companies, but it also has meant a proliferation in the number of civil servants and the cost of doing business. Anyone who has to do an underwriting through the S.E.C., compared to the cost up here it is very great. What we have tried to suggest -- we don't know the answer, but we have tried to suggest if some way

could be found for requiring that this information be provided and then a penalty if you don't do it, and a way in which a shareholder who felt he had not been given sufficient information could appeal and get that information fairly cheaply. I think some of our laws now would give them a fair amount of protection, but it is so costly to get involved that the companies can ignore it.

COMMISSIONER LEMAN: Perhaps I am not being very subtle, but it seems to me you just admitted that the groups who should enforce this without intervention by the legislature don't do it, and yet you say let us not ask the legislature to do it either. So, who is going to do it?

MR. DEACON: I think I should put it this way: We think there are two groups who are in a position to do it without legislation: One is the stock exchanges and the second the I.D.A., and if they feel they are not in a position to do it -- and up to now they haven't done it -- then the third one is some stronger compulsion in the law. When I say we don't want an S.E.C., I am saying we think you can have stronger legal minimums and still not get to the large organization necessary to police things that would go with an S.E.C.

THE CHAIRMAN: Isn't that the whole difficulty with laws? If you cannot enforce them what good are they? Laws of this kind require some special means of enforcement otherwise people don't obey them and nobody takes any interest in seeing that they do -- or, they do it at some expense to themselves, as you say. I am not suggesting I have

any strong views about an S.E.C. in Canada. I see many reasons against it, but this security business is a very difficult business to handle, as you know.

MR. DEACON: I think we would expect to do the jobs we are asking to be done that there would be some increase in personnel or in the quality of personnel so as to ensure the administration is well handled, because I don't think they can physically cope with some of the things we want done. On the other hand, we think by providing a board or a court to which you can go -- we suggest something like the Tax Appeal Board -- and I have forgotten what the costs are: About $100 or something-- maybe $25, where you can go and have your day in court without going through all the business of hiring lawyers, and so on. This is one reason we put that in the brief. In other words, we feel that most shareholders ---

THE CHAIRMAN: They don't want to hire lawyers -- that is it?

COMMISSIONER BROWN: Perhaps we should ask the opinion on the stock exchanges. In the opinion of your association do you think if the stock exchanges said that any companies that did not supply this information by the end of 1963 were going to be delisted -- do you think they are in a strong enough position to do this?

MR. DEACON: I think that they are getting to the stage, yes.

COMMISSIONER BROWN: Do you think they are now?

MR. DEACON: Yes, I think so.

COMMISSIONER LEMAN: Would you say definitely they would be strong enough if the I.D.A. was fully behind them too?

MR. DEACON: Yes. I will tell you what I have run across before, and if you have competition between the Toronto and Montreal exchanges, if you got Toronto, Montreal, Vancouver agreeing they were not going to accept listings from companies who didn't live up to these standards, if they all got together and said; "We will tick them off the board", I think it could be done. But at the moment they so far don't seem to have reached this kind of approach, and among the dealers it is a difficult thing. They will say, "Another house will take this if you insist on providing quarterly reports. We don't want to make them and we will go to a house that will underwrite our issue that doesn't insist on that". I don't know of such really concerted action---

THE CHAIRMAN: Doesn't it really get down to that, that if the stock exchanges and the I.D.A. were serious with it themselves and prepared to handle it themselves and discipline their own members and make sure their own members did supply the quality and quantity of information laid down, then you would not have to have any outside policing at all. But the difficulty arises with an organization of that kind in putting them into the position where they have to police their own members. It is a very difficult position for them to be in, but the same thing applies to all professions --- the medical profession and the legal profession. There is no

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reason why it should not be done by the stock brokers. As a matter of fact, my recollection is that the stock exchange does pretty well police itself.

MR. DEACON: They do a lot through their filing statements on the mining securities. They have greatly tightened up there.

THE CHAIRMAN: But perhaps this particular problem has not been taken hold of to the extent you think it should be.

MR. DEACON: That is right.

MR. STANLEY: I just wonder if some of these functions fall logically under the function of a stock broker. Take, for instance, proxy statements: One of the statements in our brief is that shareholders before voting their stock at meetings or being asked to vote it should be given certain information regarding the action proposed to be taken at the meeting regarding the qualifications of those proposed as directors. Why should the reponsibility of enforcing the supply of this information be laid at the door of the person engaged in trading? Surely this is a matter of the rights of the shareholders vis-a-vis the company. They are laid down in the Companies Act by the legislature, and isn't it logical to look to the legislature to clarify this rather than looking to a group of people who are merely buying and selling the outstanding securities to enforce them?

THE CHAIRMAN: If they won't enforce it themsvles, they will have to submit to the legislature. If it is outside that information that

should be made available, there may be some question about that.

COMMISSIONER GIBSON: On this matter of simply reporting on the state of the company -- balance sheets and profit and loss statements -- perhaps you could distinguish that from certain of your other recommendations which have to do perhaps more directly with the obviously questions between the shareholder and the company. But on this question of reporting, why is it such a difficult problem? Why is there this reluctance to make information of this kind available? Could you say a little more about this? There are various factors: Competition is one. Sometimes companies are very reluctant about the thought of disclosing a bad year, for example, or sharp decline, or something of this kind?

MR. DEACON: I think that is very true. I have seen cases where companies have started to make interim reports and suddenly run into a bad period and do not like to advertise it. My own view is that if they built up a reputation for reporting regularly, good or bad, they would develop a much better reputation in the investment business than one that just wants to tell the good news. Competition is certainly one of the things you hear about, and in this country it is a special problem because so many of the competitors are owned outside the country and do not have to report. They say, "Why should I disclose my sales and interim results, and so on, when all my competitors have no compulsion at all?", and that is sort of a special in Canada.

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Against that, I think the record shows the companies that do report regularly have not suffered as a result. They have certainly raised their stature in the eyes of the investment community. I can remember having a call made to me to find out about a particular company: Did I know whether they were considering bringing out interim reports? They knew the background, and that it was a good company, but they said, "We can buy lots of others where we know we can get interim information, and unless they are going to keep us informed we don't want any part of it." I think the ordinary investor, -- I think most would agree that this is essential -- if you have the feeling that when you want to get information about a company that you have got it, and that you are going to be kept informed regularly.

COMMISSIONER GIBSON: Did you see actual evidence that companies which had a good record of financial disclosure do better in selling their obligations, and their obligations sell at a better price than companies that do not?

MR. DEACON: I can think of this one particular one which sells at a lower price relative to its competitors because it has got the reputation for not saying what it is doing, and I think also you will find the ones that are disclosing it are generally the leaders. I don't know which comes first, but it seems more than an accident that they happen to be the ones doing well in business.

COMMISSIONER GIBSON: But you have given a lot of thought to this question of what is reasonable in terms of competition and these various factors?

MR. DEACON: I have talked to people about, for instance, the sales figure, and I have found if I want to find out the approximate volume a company is doing that the best way is to go to his competitor because he is usually pretty close, and I have talked to accountants about it and they seem to agree, as far as they can see, the disclosure of this information would not damage the company's interests.

COMMISSIONER GIBSON: You are not talking about breakdowns of sales figures? This gets you into an area where the competition argument becomes perhaps a little sharper.

MR. DEACON: Not detailed ones, but I think in a company that is doing various things, a general breakdown of say a pulp business -- say, how much from market pulp and how much from paper, or something like that, are not damaging and still extremely helpful to the analyst, and he knows what is going on in the paper market and in the pulp market and can make some assessments. The same with the banks.

COMMISSIONER MacKEEN: Wouldn't you agree that while a great many companies could disclose information as to their sales, there are certain other classes that might give their competitors information which would be harmful to that company? In other words, they should not do it? I have reference particularly to a manufacturer in a specialty line who brings out a new line which may or may not increase the sales materially: It would be important to his competitor to know the effect of that line.

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Again, it might be that he starts an advertising campaign that possibly would increase sales a great deal or only a moderate amount, and he wouldn't want his competitor to know that.

MR. DEACON: Yes, I don't think we would demand you get down into too much detail.

COMMISSIONER MacKEEN: What I mean is, just the gross sales which would reflect any new move?

MR. DEACON: I cannot believe, knowing the 1960 figures and the 1961 figures, and knowing he started that new line in that period, that they could automatically calculate this is what is accounting for his volume, and again from experience and talking to people, most competitors who are doing any good intelligence work at all get a pretty fair idea of what volume he is doing by checking the record in other ways. First of all, the other items may have been the ones that put his sales up, or it may have been much greater because the others went down. I don't think you would giving away too much, except in a single product company, and even that would be unsure.

COMMISSIONER MacKEEN: On interim reports, say, quarterly, there are some manufacturing industries that do a seasonal business: In other words, they may run for two-thirds of the year and just scrape along the last period, and that might make up their profit for the year, but might not the interim report convey wrong information to the shareholders, or prospective shareholders, if they just took the first three-quarters when they would see the company runnning

at a loss, whereas for the whole year they actually turned out a profit?

MR. DEACON: Again, I think our idea here is that you would always put these out with comparative figures to go with them, and this eliminates most of the problems of seasonal business. The gas business is a good one where you might get a quiet summer. Union Gas is a good one where they do provide them, and there is almost always a loss in the first half, but you have comparative years to put up against it. One of the companies puts up a five-year comparison, so that the seasonal effect does not become a problem.

COMMISSIONER MacKEEN: I think it would be all right in a utility business but I cannot think of manufacturing businesses where the disparity would be greater?

MR. DEACON: Well, retailers would have that problem, for instance, but again I do not think as long as you have got comparable figures it would matter if you showed a loss in the first half. Nobody is misled by that as long as those four or five figures are side by side.

MR. PURDY: In addition it is always possible to produce year-to-year figures if a company is in a seasonal business so that in the 12 months ending, the latest quarterly report can be compared to the 12 months ending quarterly and if your important quarter is the last quarter of the year you can check with the preceding year's same quarter.

MR. DEACON: Some companies are doing that now.

MR. SPELLER: I think it is also fair to comment that the natural gas business is about as seasonal a business as one could find. It is quite usual for the majority of these companies, depending on their franchise, doing all their reporting in a calendar quarter. They frequently report a 12-month profit below what they show in the 12-months quarterly schedule.

COMMISSIONER MacKEEN: They take the previous 12 months' figures?

MR. SPELLER: That is correct and one can, of course, check quarter by quarter comparison if he desires.

COMMISSIONER BROWN: Mr. Deacon, Mr. Leman asked you whether you were in favour of an S.E.C. type of operation and regulation and I gathered that you were not. In view of the fact that some companies are under federal charter and a lot of companies are under provincial charter and in view of the fact this is a federal commission how do you visualize that we can make recommendations in line with what you envisage without involving some form of S.E.C. type of operation?

MR. DEACON: Well, there is a companies act now, first of all, a federal companies act, and I would think if it were of a higher standard it would help by example to raise standards elsehwere. I think you have found that in Ontario. Ontario's is now in many respects a better act than the federal act and you have seen British Columbia and Saskatchewan follow pretty much the same pattern.

I think you would then see some more effective provisions coming through if we had a good federal act. We would have a chance of having the other provinces come into line.

We did not want to get into the constitutional part of it. We realize there is a problem of a central authority under the B.N.A. We wondered if there might be some opportunity through the fact that this might be considered inter-provincial trade by which the federal government could have something to say about what goes on in the securities business.

There has been some movement towards uniform working out over the years. It has been

pretty slow. Maybe the Commission could find a way of recommending how it could be speeded up but as you know, they were working on a uniform companies act and have been working for some years.

COMMISSIONER LEMAN: Mr. Deacon, if I am right in continental Europe there are a large number of companies that do not report according to your standards , and large ones too, and as I understand it that makes North America rather reluctant to invest because of that reason but within their own area how do they contend with this lack? The public seems to be reasonably satisfied, doesn't it?

MR. DEACON: I think what happens characteristically there is that there are sort of large bank associations with some of these companies and the technique, as I understand it, is you get to know the people in the bank and the banks keep close touch and sort of know which books they are using.

MR. SPELLER: Also too, I think it is fair to comment, that they do not have the broad securities ownership in general there that we do.

MR. DEACON: It is coming. Germany has greatly strengthened their requirements. They are very aware of this on the Volkswagen issue, I think they put out, to try and develop a broader ownership. I think they are coming around to the North American approach.

COMMISSIONER LEMAN: I would like to ask you another question which is a little bit out of your brief because you have covered the area of reporting mainly but in discussing the advisability of having an S.E.C. there is another aspect there

and that is equitable dealings in securities. From that angle would you care to comment on the advisability of having one or not in view of the facts of the case in Canada?

MR. DEACON: We have not really gone into this part of it, I suppose, but again I think if you provide a proper information on which to base decisions to buy or sell which is what the individual has to make and through your securities commmssion make as sure as possible that the people who are in the business are competent and well qualified, then I think that our suggestion about providing a sound law and penalties and a third part, to make a person not just have a penalty and go on doing it but forfeit the stock I think that may achieve something really. Our securities commissions here are pretty active and you can see how as a bad apple get thrown out of one they would try another province and then they would get thrown out of that and shifted on to another and as they total standards are raised eventually we would hope to solve that problem through a better act and better administration.

COMMISSIONER LEMAN: You see, you are security analysts and through these reporting suggestions you have made in the securities field you are addressing yourself to the sophisticated securities investor but what I am worried about is the unsophisticated investor who practically has to be protected against himself, doesn't he?

MR. DEACON: Yes.

COMMISSIONER LEMAN: You will find that although securities analysts will go to great trouble

to analyze an investment and recommendations are made to others I think you will find the average shareholder who is not a professional in Canada does not even read the annual report.

MR. DEACON: Iam not too worred about this because I think most investors do consult their broker and if the broker is well qualified and has access to information he can advise them and they are more likely to listen to him. I think you have got a better chance of keeping it straight if you have got the information.

COMMISSIONER LEMAN: There are a couple of "ifs" in your answer?

MR. DEACON: Well, when people seem to think there is something magic about the long distance telephone call telling them that if they buy a certain stock they will double their money overnight I do not know how you can get that fellow off the list.

MR. SPELLER: If I may, I think that it is true a sophisticated investor has generally for many years in most communities had the information he needed to make his investments. Certainly the broader type disclosure that we are interested in achieving is designed to help primarily if not entirely this very small investor and certainly, as Paul has pointed out, the availability of this information does allow those of us who arein business to be in the position of counselling small investors as opposed to large ones.

COMMISSIONER GIBSON: Could you on this subject give us some idea of what proportion of the

brokerage firms you have as active members of your society?

MR. DEACON: We have 268 members.

MR. GOLDRING: I would say by far the vast majority of brokerage houses would have members of their firms members of securities analysts. It would be well over 90 per cent if you want a percentage figure.

COMMISSIONER BROWN: But is it at the department level?

MR. GOLDRING: It depends who attends the meeting. Even if the membership is in the partner's name it may be somebody in the analytical department who attends.

COMMISSIONER BROWN: Does he carry a vote on the stock exchange?

MR. GOLDRING: Our membership would generally not, no.

MR. DEACON: I think there is a greater attention paid to the analyst now because if they want to sell institutions or anything else it is competition of people with the best information possible and the best analysis of the value of securities and a good record goes a long way to get in the door the next time.

COMMISSIONER GIBSON: This applies to the sophisticated investor but not necessarily the small investor.

MR. DEACON: I think the small investor is the same thing. If he has done reasonably well and a sound securities analysis has produced that result he is willing to go back and invest again.

I find, for instance, on investment clubs -- we get a lot of mail on these -- they get books on how to analyze securities and they say: "Can you provide the sales figures for such and such a company?" Sometimes they say: "I cannot find them anywhere in the United States?" And yet this is a basic analysis which they are supposed to have. There are literally thousands of these people around and I think it is a marvellous potential market for the securities business and yet they come up against a lack of information and they perhaps make wrong decisions or get fed up.

COMMISSIONER LEMAN: A little while ago in a burst of generosity you admitted the S.E.C. has done a lot of good in the United States. Now, can you tell us what harm they have done?

MR. DEACON: Well, I think they greatly increased the cost of doing an underwriting for one thing. I don't know -- maybe some of my underwriters here may give you the comparative figures but I know thecost of putting something through S.E.C. is pretty gigantic.

MR. BARLOW: I have not had too much direct experience with American underwriters but it is generally felt that the legal costs are three or four, maybe five times what they would be here just to prepare the necessary written documents, and also there is atime factor involved in the processing of the documents down there. Printing costs are very expensive and very heavy so in the event we had an S.E.C. type of programme here it would certainly provide a burden of financing costs of Canadian companies

which at the present time they do not have to carry.

COMMISSIONER LEMAN: Is this inherent in having any securities commmssion in the country or is it the fact that in fact you feel that perhaps they have gone too far?

MR. BARLOW: I think it is part of the bureaucracy that has grown up around the S.E.C. that has been partially responsible for these costs.

MR. GOLDRING: There are two reasons for our opposition to the S.E.C. in its exact form in the United States. One is cost and it affects the smaller companies most severely, of course. The second lies in the rules which might be -- at first take certain full disclosures which are made by devious measures to avoid those rules. They make all kinds of amendments and it finally ends up by the lawmakers in their wisdom giving final discretion to judge a particular point. This introduces to us a very ominous factor in the financial flow of funds, namely, an official who has discretion to rule one way or the other and he is really a third party. I do not refer precisely to government control; I refer to more or less bureaucratic control. Our idea here is to obtain more facts and figures from companies but without the octopus-like organization which would necessarily review all financial statistics which come from all companies under the proposed improved laws.

COMMISSIONER BROWN: Do you suggest that there are enough competing jurisdictions in quantity to prevent Parkinson's law becoming effective?

THE CHAIRMAN: Well, you want these

provincial authorities to deal with this particular problem.

MR. GOLDRING: We do not envisage any authority pursuing a full review of all financial statements.

COMMISSIONER BROWN: We are talking about the information you are asking for here.

MR. GOLDRING: We are suggesting that in the laws of the province and the federal government that there is a cheap, easy recourse and penalty to those committing offences in order that there would not be this bureaucracy. This is an alternative route which may achieve the desired end.

COMMISSIONBROWN: You still would have to have some enforcement agency.

MR. GOLDRING: Right, and this would be the court or a board similar to the Tax Appeal Board which would be activated only upon the registration of complaint by a shareholder or a member of the public.

THE CHAIRMAN: Well, why not just use the Securities Commission that we have?

MR. GOLDRING: It seems to us that they would be good for 95 per cent of the material.

THE CHAIRMAN: You want a new board set up similar to the Tax Appeal Board. Why not use the board we have which has some familiarity with the securities business or you might prefer some over-all federal board in substitution for all the provincial?

MR. GOLDRING: This would certainly be desirable from the point of view of efficiency but whether it is possible constitutionally I do not know.

THE CHAIRMAN: I do not know whether I would go that far with you but if anything is to be done about this, if it is desirable to have any step taken that will be effective, it seems to me there has to be some sanction and it is either a voluntary system within the membership of the stock exchanges or the Investment Dealers' Association or the only alternative is some legislative sanction.

MR. DEACON: I think you cannot count too much on the I.D.A. in one sense where they do not have to come up especially to the I.D.A. A company might not go to the market for years so there is no opportunity to force that company to do anything. They could fall back on what is in the law and in the second place on the exchanges all of the companies are not listed so again you come back on the law as the final authority. I think there is something to be said for having a central pattern or certainly uniformity of legislation. I think uniformity is something we would prefer to see.

COMMISSIONER LEMAN: Our Income Tax Act has complicated enactments and, the same as you described a minute ago where the Stock Exchange makes simple rules, people try to get around that and they make new rules to block the holes, etcetera. What I am wondering is, do you perhaps visualize the possibility that a securities exchange commission could work well and smoothly and not fall into bureaucratic tendencies by watching whom you appoint to such a committee.

MR. GOLDRING: Would you envisage this commission reviewing all the material which is put out by every company? In other words, if a company, small, junior industrial, wishes to raise financing, would it have to file with this board the full documents as required by the U.S. Securities Commission?

This is, I think, essentially the difference in our approach, that they would, in our feeling, have to file with a recording secretary all this material and make it public, and they would be obliged by law to make full, complete and plain disclosure of this material; but there would not necessarily be a number of obviously highly paid and necessarily well-trained people to peruse all this material in order to make sure that what it purports to say is so. This is what the S.E.C. does and it has, as you know, a gigantic staff in order to accomplish

it.

THE CHAIRMAN: As I understand it, the S.E.C. now receives all this information and they look over it and check every statement that is made and decide then and there whether it is right or not.

MR. GOLDRING: Yes, that is substantially correct.

MR. BARLOW: Not only the statements that are made but the statements that may not be made.

MR. GOLDRING: Exactly.

MR. BARLOW: There is a deficiency regulation requesting additional information.

MR. STANLEY: I think they decide then and there. That is one of the difficulties.

THE CHAIRMAN: Also the difficulty is, no matter how fine an organization is set up on paper, everything depends on the men who administer it. You may have a very satisfactory and liberal administration for awhile, but then a little later it may change, be tough and probably unreasonably so - using "liberal" with a small "l".

COMMISSIONER GIBSON: In fact you are saying that you would like to have full disclosure as defined in your brief, made obligatory under the law, but that you would not have any substantial enforcement organization or checking organization. Is that a fair statement of what you are saying? - To rely on security analysts

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[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

[illegible]

and the public and so on.

MR. GOLDRING: To give evidence.

COMMISSIONER GIBSON: Check up and so on.

MR. GOLDRING: Of untrue statements, and an easy direct access, so that a person who discovers a falsehood or error, breaches of law, can inform the government and the government can then take action if it deems this is sufficient as far as a breach is concerned; or conversely, if the government does not choose to do so, the shareholder~~t~~hen or the member of the public, can then have access to a reasonably efficient - just thinking out loud - rather flexible type of board made up of members connected with the financial business in some way or other - accountants, members of the stock exchange or some such people as that.

COMMISSIONER GIBSON: Would there be much "teeth" in this?

MR. GOLDRING: It is effective in the Combines legislation.

MR. SPELLER: This disclosure of the type we have outlined here, would be an integral requirement in the Federal Companies Act, and we would hope that there would be "teeth" - the same teeth that do exist in any clause in the Companies Act now.

THE CHAIRMAN: Is that not the system under which the Securities Commission work here, for all disclosure?

MR. SPELLER: Yes, sir. I think we would like to amplify - in short we would like to use existing machinery.

THE CHAIRMAN: To indicate what must be disclosed in greater detail.

MR. DEACON: We want more detail.

MR. SPELLER: Correct, and we hope therefore to have the main, if not all the advantages and a minimum of the disadvantages of over-centralization.

COMMISSIONER GIBSON: Do you see much evidence that your own efforts have brought forth results? You have been meeting for some decade, haven't you, and have grown quite a lot. You have been asking people to tell you about their companies. Have you noticed a spread of the results you are trying to have?

MR. DEACON: I would think so from my personal experience. I can remember one chap that went on the board of a company for the first time, and at the first meeting he happened to mention about public quarterly reports, and the management said: "Would you like to have quarterly reports? Sure, we will provide them." Somehow it had not occurred to them.

I would think also that the chartered accountants - and we ran in the "Post" this contest for the best report and it has really remarkably improved in the attention that is paid to it. This is all on a voluntary basis, and I

think a lot of companies should be commended for what they have done. They have gone far beyond what is required by law. However, there are still a great number who have not, but there is a gradual improvement, I think all of us would agree.

MR. SPELLER: I think there is no question the standard of reports over the past decade has improved very significantly, and it is noticeable in specific industries. Some industries have not kept pace, but there is no question about it. Who can take credit for this is problematical. We hope we have been helpful.

THE CHAIRMAN: Thank you very much, gentlemen.

--- Adjournment.

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Royal Commission on Banking and Finance

Hearings held at

Toronto

Vol.

11A

Date.

April 13 1962

Official Reporters
F.J. Nethercut and R.J. Young
Toronto, Ont.

VOLUME 11A

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This brief concerns the N.H.A. mortgage market and its aim is to broaden the market in N.H.A. mortgages, and find new sources of private funds of all sizes to finance home ownership in Canada, to assist the Government in freeing the funds that are tied up in their direct lending programme with Central Mortgage & Housing Corporation, to create a secondary market, which would enable present N.H.A. mortgage lenders to diversify their portfolio, and to interest other large investors, such as Pension Funds to buy N.H.A. mortgages and give them a measure of liquidity.

Proposal

1. Continue the offerings of N.H.A. mortgages originated by C.M.H.C. and bring C.M.H.C. into the mortgage market in the same way the Bank of Canada acts in the Government market.
2. Establish banking arrangements to facilitate dealers, who hold positions in N.H.A. mortgages and streamline administration transfers.
3. To issue funds (F.N.M.A. type) to attract the small to medium investors, having from $1,000 to $50,000.

The Present Mortgage Picture

The N.H.A. Act was set up to encourage home ownership and to enable large lenders to grant loans and to administer the mortgages. This was accomplished by the Government guaranteeing to make good any losses on foreclosures.

Lenders

The lenders at the present time are the Government, through C.M.H.C., the chartered banks, the large insurance companies, trust companies and pension funds through the auspices of a trust company acting as their agent and administrator. The total number of approved lenders is 76. In 1961, the Government desired to increase

the number of buyers and offered blocks of mortgages owned by C.M.H.C. to approved lenders and investment dealers on competitive tender. Three series of offerings, totalling more than $45 million, have been sold. Of the investment dealers, only Gairdner & Company and Greenshields Inc. have taken an active part. Some Trust Companies and banks have also tendered. Nearly all of the $45 million of mortgages sold have been sold to buyers that already had purchased N.H.A. mortgages and were approved lenders. Less than five brand new mortgage buyers have been found to date, but some new interested potential buyers are coming along.

The approved lenders have sold more than $320 million of N.H.A. mortgages to others. More than $160 million has been sold to pension funds. Most of these pension funds are administered by the trust companies, and are the approved lenders that are selling. A large part of the remainder has been sold to foreign insurance companies and other small domestic insurance companies, who are not approved lenders. The seller (an insurance company or trust company) continues to act as administrator. In most all of these cases, then, the field of buyers, whilst spreading, is still kept in a very narrow family relationship.

Problems found in C.M.H.C. Tender and Mortgage Marketing.

The present C.M.H.C. tender has failed to interest new buyers, or broaden the market appreciably. It has, then, not accomplished what it was set out to do. This has been caused by the poor marketability of the N.H.A. mortgages compared to bonds. The poor marketability is partly caused by the inability of any jobber to buy the mortgages and finance them in a comparable way to the way he can finance bonds and stocks on call loans. At the present time, the Bank Act does not clearly allow the chartered banks to finance N.H.A. mortgages.

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They have chosen not to finance them for the dealers.

Another problem is that there is really more than one type of N.H.A. mortgage. Those mortgages on houses that are in large Metropolitan areas, or in, or near large Cities, can be administered by trust companies and insurance companies from their local branches. These mortgages are of interest to approved lenders and administrators, who have a national branch system. In effect, these mortgages can be administered cheaply and, therefore, command a higher price. Unfortunately, there remains a large number of mortgages on houses in smaller Cities and Towns across the country. Few lenders have the facilities to administer these mortgages and, hence, they are of no value to them. They, therefore, command a lower price, or are of just no interest to lenders at any price. (They would sooner buy where they can administer, rather than have others administer). Since the trust companies are the country's largest administrator of pension funds, they influence the pension funds to only buy mortgages in places where they, themselves, can administer. All of this tends to break the national market into small regional markets and gives a great advantage to the Metropolitan areas. In buying a mortgage, then, administration ranks as high as investment quality and price, and tends to offset and make more difficult the establishment of a secondary market.

There still remains in the country restriction on investment that prohibits some pension funds from buying N.H.A. mortgages. An example of this are Provincial and Municipal employees' pension funds, which in every Province of Canada, except Saskatchewan, are restricted from buying mortgages at present. This eliminates a large potential source of funds from the market.

The Jobbers

With the restriction of the Bank Act, in not allowing mortgages to be

carried on call loan, the jobber is unwilling, and in many cases unable, to finance mortgages and, therefore, can only act as an agent. This means that a potential seller of a block of mortgages must either find a buyer himself, or tell a dealer that he will sell, and the dealer will try and find a buyer. The seller has no assurance at present when he can sell or at what price. If dealers could finance their mortgage inventory, this part of the problem would be solved, and the dealer could fill the middleman function.

Administration of the mortgages presents another problem. Most approved lenders would be willing to sell their mortgages if they could keep the administration in their hands as the fee charged for the administration makes administration profitable. Along with this, the way in which the mortgages are administered varies from one to the other. The way the records are kept also varies. This makes the transfer of administration difficult.

A Course of Action

1. For a secondary market.

Change the Bank Act to make it possible for the chartered banks to finance N.H.A. mortgages in the same manner as bonds.

Effect title transfer through the Bank of Canada in the same way that Government of Canada bonds can be transferred, i.e. if an owner of a Government bond resides in Vancouver and he decides to sell, and then going through a dealer, a buyer of these bonds is found in Halifax, the Bank of Canada agency in Vancouver will accept the bonds and issue the same issue in Halifax, registered in the new owner's name the same day. This makes for fast, efficient movement of securities in a national market. The Bank of Canada, as the Govern-

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ment's agent for C.M.H.C., could also effect transfer for mortgages in a similar manner with few added complications.

As regards administration, C.M.H.C., which is set up to administer mortgages on a national basis, should be allowed to asminister any mortgages regardless of which approved lender originated them. They should be willing to do this at a set fee. This would overcome the problems that arise when a buyer of mortgages tries to get reluctant administrators to administer. Administration would not, then, rank as a factor as large as the price of the mortgages and would help to create a national market in the mortgages.

At the present time, if an N.H.A. mortgage goes into default, and is foreclosed, the Government Guarantee does not assure that the lender will receive his money back with interest to the date of payment. If foreclosure is lengthy, the lender suffers an interest loss. The result of this is that it is necessary to value the Government guaranteed mortgages, partly on the basis of where they are located and who is the mortgagee. This, then, established different prices for the mortgages even though they are all guaranteed. In effect, then, a penalty is charged if court action on foreclosure is lengthy. If this could be reversed to give a premium for speedy action, there would be an incentive to the administrator to act quickly, or if the Act was changed to eliminate the 2% reduction in interest after six months, and a larger allowance was made for legal expenses, foreclosure would not rank importantly in the investor's eyes.

C.M.H.C. should, besides making blocks of N.H.A. mortgages

available for the market from time to time, enter the market with a bid and offer for blocks (same price irregardless of location). In this field, they would act like the Bank of Canada in establishing a relatively smooth market. The reserve bid (slightly below the market) would tend to make all N.H.A. mortgages worth the same, i.e. the mortgages would trade on their residual Government guarantee and would establish a national price level, dependent on general interest rates. The offering by C.M.H.C. of blocks of mortgages, would also supply the market with its temporary requirements.

The ease of transfer, administration by C.M.H.C., banking facilities and C.M.H.C. market action, would, together, continue the broadening of the secondary market and would ensure the entry of other approved lenders as both buyers and sellers, and would make N.H.A. mortgages a liquid investment.

2. The Small Investor

The secondary market for N.H.A. mortgages, even when fully developed, will probably never be able to use the funds of the small investor (with from $1,000 to $50,000), because of the cost of administering, paying and reporting to a multitude of small mortgage investors.

For the small investor, then, another medium of mortgage investment is necessary. Proposals have been made and a few companies have been established to buy N.H.A. mortgages and issue debentures, which would be sold to the public in small denominations. Such a development of a multitude of mortgage investing companies, would be an undesirable development in the Canadian capital market. Their development would

be undesirable because -

(a) The underlying credit would be the Government guaranteed mortgages exclusively. The rates and yields at which their debentures would sell, would tend to vary, depending on the company's backing, and sales ability. This would lead to public confusion and suspicion of the underlying security.

(b) The cost of administering and operating such a company is sizeable (transfer agents, bond commissions, auditors' annual reports, etc.). This would result in a spread between the net yield on N.H.A. mortgages and the debentures offered being wide (at least $\frac{3}{4}$%). The only way to minimize such expenses would be to establish huge mortgage companies, which might tend to monopolize the Government guaranteed mortgage field. The mortgage companies, acting as principal in new and old mortgages, would, as a national development, become the secondary market to the exclusion of independents.

A better solution would be for C.M.H.C. to market its own debentures in the way that the Federal Housing Administration in the United States operates. This would allow the C.M.H.C. to offer larger blocks of bonds than an individual company could, and would allow transfer and registration of the bonds in the same efficient way that the Bank of Canada operates. This method would be best for several reasons -

1. Offerings of C.M.H.C. bonds could be timed and scheduled to take into account Government and C.N.R. financing to take the best advantage of market conditions.

2. The cost of borrowing would be lower than having individual mortgage

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1. Offerings of C.M.H.C. bonds could be timed and scheduled to take into account Government and C.N.R. financing to take the best advantage of market conditions.

2. The cost of borrowing would be lower than issuing individual mortgage

companies offering bonds, and the saving would accrue to the Government through C.M.H.C.

3. Public response and acceptance would be much wider than if private companies operated, as the bonds would bear the guarantee of Her Majesty's Government.

4. As there would be fewer issues of larger size, the marketability and liquidity would be higher and this would induce more investors to buy.

5. The bonds would be sold through all of the investment dealers in Canada and would, then, have their interest and would command a much wider distribution than would the bonds of mortgage companies that are privately backed by only a small number of dealers. It must be remembered, that the market for mortgage debentures are the small investors that must be contacted in the far reaches of the country. For this, all Investment Dealers, Banks and Trust Companies are needed.

SHORT TERM CAPITAL MARKET

This portion of the presentation is based on a need to assist Canadian corporations to minimize costs of borrowed money through their participation in a more efficient market for short term funds.

Our study with its concluding recommendations should benefit borrower and lender, alike.

1. By reducing the middleman spread in commercial banking, borrowing costs may be lowered and yield on investment capital improved.
2. More efficient middleman activity in the money market will provide the lender with better access to investment channels and add continuity to the market for borrowers. This could be achieved by a middleman active as principal and functioning as blending agent in melding borrowers' needs and investors' funds in a continuous, efficient market fashion.

The results of such a development would be savings for large "prime rated" corporate borrowers and lenders.

The Marketplace To-day.

1. Meeting Borrowers Needs

   Two sources of funds are currently available to corporate borrowers, chartered bank loans at 5½% "prime rate" (or higher), from the market - corporate savings for hire at rates varying 2¾% (demand) to 3½% (90 days). During the past 5 years, money borrowed from the market on demand has averaged 1.5% cheaper than "prime" bank loan rate.

2. Problems in Satisfying Borrower Requirements.

   Bank credit is relatively expensive and not altogether reliable over a period of time. Market supply of credit is available at lower but varying prices, in changing supply, for varying terms. In the marketplace, borrower demand and investor supply seldom meld for precise size and timing or for

mutually desirable terms. It is a common occurance for even prime borrowers offering reasonable rates to have to wait as many as 4-5 days to borrow their requirements in the market.

3. A Need Exists for -

"Blending Institution" engaged in smoothing supply-demand factors on a continuing daily basis. This function would be aimed at alleviating market probelms created by the influx of note offerings (borrower requirements) at times when supply of funds is insufficient for the moment, or by the influx of funds for investment when the supply of notes is inadequate. (The latter is less of a problem). Banks are unwilling to serve this function because it is opposed to their activity in advancing loans.

4. The Market Has Provided its Own Solutions, but with Undesirable Consequences.

(a) Emergence of agency agreements, has led to jobbers acting as principal in buying a corporation's notes up to an agreed upon maximum limit. In guaranteeing to buy a corporation's notes within a specified period of time. (i.e. 48 hours) the jobber has created the situation of a non-bank institution granting lines of credit to corporate borrowers against their fixed term promissory notes. This development is impeded by bank's refusals to accept commercial paper for call loan purposes. The jobber must then resort to non-bank sources of loan funds.

(b) Emergence of non-bank sources of funds

Corporations with funds to invest for short periods of time have

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(b) Emergence of non-bank sources of funds

Corporations with funds to invest for short periods of time have

recognized this need of dealers to obtain loans secured by commercial paper. Since banks refuse to grant such loans, trust company and non-financial corporate sources of funds have entered the market to fill the void left by banks. However, it would be misleading not to observe that even if banks did advance loans against commercial paper collateral, the rate would likely be much higher than the yield of the collateral and jobbers would seek to reduce carrying cost by borrowing from non-bank sources when cheaper. This situation would undoubtedly have existed during 1961-1962 to the present, but not during 1959 - early 1960.

(c) Emergence of non-bank, non-resident sources of funds

U.S. Commercial banks have begun to enter Canada as country bankers for earlier paper inventory. Rates compare favourably with those of domestic non-bank lenders and funds are more reliable and sizeable. The exchange hedge is handled by the lender.

Hypothesis -

If it is desirable to manage credit these devlopments are undesirable, in that the wide diversity of non-bank credit and especially non-resident credit is difficult to control.

It is desirable to direct this type of credit activity through a controllable, financial-type group, i.e. jobbers acting as middlemen performing a blending function dealing in commercial paper as principal with machinery permitting such a development.

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Elaboration of Market Problems

Corporate borrowers are essentially concerned with two borrowing considerations - loan cost, and reliability of loan source. During conditions of other than extreme credit stringency, banks have qualified as the most reliable source of credit. One might, therefore, consider that reliability is worth a price to the borrower, and, furthermore, that prime rates have fluctuated within a narrow 5¼% to 5¾% range, while market short term rates fluctuate widely - even sometimes exceeding prime rate (when banks curtail lending forcing borrower into the market for funds).

Nonetheless, during times of credit ease, and lowering money market rates without a comparable reduction in the bank's lending rate, the money cost spread penalizes the prime borrower borrowing from his bank to such an extent, as to force him from his bank to the market for more economical loans. During the past year, market money has been 40% cheaper than bank money. During the past 5 years, prime rate has averaged 5.6% and market money 4.1%, so one might conclude that the cost of bank reliability has been 1.5%. On this basis, there is little justification for a corporation Treasurer to remain with bank loans if this is his only purpose.

The banks are forced to reluctantly contribute to their embarrassment. Credit added to the economy through the banking system often pushed market rates low, even in the face of increasing corporate loan demand, thus aggravating the situation for the banks, while ensuring sufficient market funds to satisfy the borrowing needs of even the more marginal borrowers on both an attractive (cost) and reliable basis. The market has proven itself to be no less dependable a source of funds for prime borrowers during the past 5 years' period, than the banks themselves. Prime

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borrowing corporations realise this, and banks realise this. Still no workable commercial paper market exists, nor have the banks permitted its existence.

The money market jobber, for competitive reasons, cannot ignore the short term borrowing needs of prime corporations. The jobber will underwrite the borrowers' requirements on a two-day delivery basis, and attempt to locate loans (necessarily off-street loans) against those notes he is unable to place in the agreed upon 2-day delivery period assuming market risks, transfer taxes and re-registration problems. More than that, the jobber has translated a potential bank loan into dealer off-street loan. Since commercial paper is unacceptable collateral for bank loans, the dealer is placed in a less favourable position to handle the loan than if the borrower were, himself, to arrange temporary bank accommodation until market funds became available.

This development impedes the placement of term notes on the market because the term notes "float" in the market among "country-bank" corporate investors, as "dealer loans" on call at rates often above 60-day term note rates. The dealer finds himself in the position of offering term notes at rates below that which he must pay for loan accommodation, while he seeks a permanent buyer from among the same corporations who, themselves, are the "country bankers"

It is not surprising that market rates for 30 to 90-day term paper tend to disappear into a single level, subject only to fluctuations in the off-street loan rate.

We view these devlopments as highly disruptive to the maintenance of an orderly money market structure. Furthermore, these devlopments threaten not only the existence of the near term rate structure, but due to the size of "off-street loans", threaten the entire market structure with the potent of concerted forced selling some time in the future.

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[illegible]

We consider these developments as having arisen from market inadequacies that we, herein, seek to have corrected.

<u>The right of prime borrowers to cheapest available short-term capital.</u>

Capital cost is an important item in product cost. Low cost production is a desirable aim if industry is to compete successfully in export markets or in domestic markets against low cost imports.

As with any cost consideration when money market rates decline significantly below banks' lending rate, borrowers will, and should, seek the source of the lowest cost short term capital. Canada has witnessed a $1\frac{1}{2}$-year period during which time this commercial banking spread has exceeded 2% per annum when "prime" corporations have, or could have, borrowed all their requirements in the market at a 40% average saving over bank loans at "prime-borrower" rate.

Banks should not thwart this process by refusing to accept commercial short term note collateral.

Banks should assist the market processes by lending against paper at rates perhaps slightly above market rates, but certainly on a schedule geared more closely to market short term rates.

<u>Developing Efficiency in the short-term capital market.</u>

In Canada, investment dealers have earned a fine reputation for underwriting the capital requirements of business and industry. During the past 7 years, Canadian Money Market Jobbers have sought to demonstrate their willingness and preparedness for handling the underwriting and marketing of the short term capital needs of Canadian corporations.

To effect a truly two-sided short term market, certain preparations must be made -

1. Ontario & Quebec Transfer tax on securities shorter than 9 months or a year, must be eliminated. It is not sufficient to avoid such taxes by dealing in new forms of paper not specifically defined in the Transfer Tax Acts as "securities" for purposes of the Act. Furthermore, principal buying and selling on different dates or at different prices is subjected to tax on both the buy and sell transfer.
2. "Bearer Form" Registration for short term notes is necessary to permit fast un-complicated transfer of ownership.
3. Banking Facilities at reasonable cost is essential before a jobber, acting as principal, can undertake the purchase of notes for resale on his own account

These three points are basic to the establishment of a foundation for a two-sided market in commercial short term paper.

An additional measure should also be considered in respect of short term capital market. In this presentation, we shall term this institution "merchant bank".

Role of "Merchant Bank" in short term capital market.

This institution would perform a function between that of the presently defined "chartered bank", and that of the money market "jobber". Its clients would be primarily corporate borrowers and depositors.

Its powers would include the rights to -

1. Take deposits and pay interest on these deposits.
2. Lend to corporations against their promissory notes.
3. Act in foreign exchange and securities market for own and client accounts.

4. Accept and endorse corporate short term paper.

Functions of this institution would approximate some, but not all of those functions performed by trust companies. Its role would be to extend credit to corporations indirectly by purchasing and maintaining inventories of corporate, promissory and collateral trust paper for resale. Properly performed, its operation would provide funds to prime borrowers at truly prime market rates.

The "Merchant Bank" would sharply curtail off-street dealer loan activity by its function of itself financing the short term notes that now make up off-street loan collateral. The Merchant Bank would earn its living by borrowing more cheaply than it would lend. This is possible by "lending short, but borrowing shorter".

Merchant Bank operation would not only reduce or eliminate off-street loan activity - it would transfer it from many non-controllable, non-financial organizations to a few financial-type companies under the scrutiny of the central bank.

Summary -

The currently existing need for an efficient short term market for the temporary investment of corporate funds or for the provision of short term capital at economic rates is economically justifiable.

An interested jobber group is prepared and eager to "make" a short term "capital" market providing the (Absent) second side of an efficient two-sided money market.

Certain provisions must be made, and to this purpose we have made briefly defined recommendations - among them the consideration of a "middleman" or merchant bank.

We are pleased to have had this opportunity to submit our views and recommendations to your consideration.

JOHN R. CAMPBELL Q.C.

372 BAY STREET
TORONTO 1
CANADA

TO: Royal Commission on Banking and Finance

Gentlemen:

1. This submission relates to certain aspects of mortgage financing under the National Housing Act, 1954. It is concerned with secondary market activity in N.H.A. mortgages and, more particularly, the public and private distribution of securities secured by N.H.A. mortgages to provide funds for secondary market activity as well as new construction.

2. This submission is made in my personal capacity as one who, since 1954, has been associated with various investigations undertaken and proposals made by investment dealers, Canadian chartered banks and private interests concerning secondary market activity in N.H.A. mortgages. I have also acted as a lawyer in a substantial amount of N.H.A. lending, including certain transactions where the funds were provided from the sale of securities.

SUMMARY

3. Most estimates fix future Canadian residential requirements at 125,000 to 150,000 new dwelling units per year over the next ten years and that a growing proportion of the new units will be in various forms of multiple rental housing for lower and middle income families. It is expected that N.H.A. financing will be sought for a substantial proportion of this new construction and that this will require from $600 to $900 million N.H.A. funds per annum.

4. Current indications are that N.H.A. funds in this volume will not be available from private sources unless there is a new stimulus in N.H.A. lending, failing which continued and increasingly heavy direct Government lending will be necessary. The usual private N.H.A. lenders are not keeping pace with the requirements and in fact some have discontinued N.H.A. lending altogether. Alternate sources of N.H.A. funds have not developed to any great extent nor has there been much secondary market activity in N.H.A. mortgages. Areas of special direct employment of C.M.H.C. funds such as public housing, university residences, housing for elder citizens will continue to make heavy demands.

5. By improving certain of the terms of lending, more private money will be available for investment in N.H.A. mortgages and secondary market activity will be stimulated. Because responsible secondary market activity means greater liquidity, even more private money will be willing to invest in N.H.A. mortgages. Older institutions should adapt and new institutions should grow to provide funds to support both secondary market activity as well as additional funds for new mortgages. Corporate securities, backed by N.H.A. mortgages and equity in new companies established for the purpose, should prove more attractive to a broader group of investors because the equity covers risks not covered in direct investment, there is far greater liquidity, there is no mortgage administration problem and shorter term investments can be made available.

6. Thorough investigation has indicated that a company, organized to deal solely in N.H.A. mort-

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6. Thorough investigation has indicated that a company, organized to deal solely in N.H.A. mort-

gages, can raise the capital required to support borrowings, which the market will dictate, for investment in new and existing N.H.A. mortgages, estimated at the outset to be $300,000,000. By reason of various commitments received in respect of the administration of mortgage portfolios and the servicing of its debt, such a company can cover its operating expenses and provide the necessary reserves on a feasible basis. At many times during the last few years such a company could have borrowed substantial funds at rates which would have permitted its profitable operation. It is reasonable to assume the same for the future and that, therefore, additional capital would be obtainable as required. Competitive companies would no doubt also come into being and other comparable financings and operations undertaken.

7. Activities undertaken in the above described way could rapidly result in there being no overall shortage of N.H.A. mortgage money and hence work towards reducing interest rates. The Government could substantially end its heavy direct lending activity, except in remote areas, periods of tight money and other special situations. The Government could gradually (or periodically, rapidly) dispose of the large portfolio of mortgages held by C.M.H.C. The forward planning that could be done by builders and the economies in construction costs which could thereby be effected if long term forward mortgage commitments were available to builders could reduce the cost of housing.

8. In order to facilitate the foregoing, it is submitted that the Government should:

(a) Amend the existing unattractive parts of

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the Act and Regulations such as: title acceptability, certain aspects of the insurance settlement, inability of approved lenders to make loans as agents, possible technical voidability of the mortgage loan insurance policies; permit builders to pay reasonable standby and commitment fees.

(b) Provide for the sale of mortgages out of the C.M.H.C. portfolio in amounts and on terms which will prove acceptable to the greatest number of potential buyers. Have C.M.H.C. prepared to service the mortgages it sells on a basis competitive with approved lenders.

(c) Amend the Bank Act specifically to permit chartered banks to make N.H.A. mortgages at rates of interest from time to time obtaining, notwithstanding other interest rate limitations to which banks may be subject.

(d) Standardize the insurance obligation on all mortgages made under the 1954 Act, primarily to raise the insurance obligation to 100% on all N.H.A. mortgages.

(e) Amend the Canadian and British Insurance Companies Act to permit securities based on N.H.A. mortgages to be legal for life without resort to the basket without the necessity of registering the financing documents against every title.

(f) Reserve C.M.H.C. direct lending to special situations rather than continuing the large

volume of direct lending that has obtained recently. Permit C.M.H.C. to make low interest loans to approved lenders for special situation N.H.A. loans. Permit C.M.H.C. to be a buyer of last resort of mortgages created for resale.

MAIN BODY OF SUBMISSION

9. On the basis of economic studies of the available information, it has been decided that $5,000,000 initial capital would be adequate to support in the neighbourhood of $300,000,000 of short and long term borrowings, thus providing substantial new funds (in great part Canadian) for investment in N.H.A. mortgages. The projections of future operations indicated such substantial growth possibilities that it appeared as if a new institution established for the purpose could become a responsible instrument in a secondary market for N.H.A. mortgages and that other companies and financial institutions would be encouraged to enter the field in a competitive way. It is certainly no part of this submission that any protection is sought to provide any exclusivity in the field to any one institution. In fact, full competitive opportunities to any others interested is basic to this whole matter.

10. The operating policy of such an institution would be to deal only in first mortgages insured under the National Housing Act, the main business purposes of such company being:

1. To purchase and hold outstanding N.H.A. mortgages.

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1. To purchase and hold outstanding N.H.A. mortgages.

2. To assist in the creation of new N.H.A. mortgages.

3. To call a "trading" market in outstanding N.H.A. mortgages; and

4. As a result of the foregoing operations, to become the owners of a large and normally increasing volume of N.H.A. mortgages.

It is to be noted that such companies would not necessarily undertake the administration of the mortgages in their portfolios, but rather this service could be performed by existing approved lenders, including, to a great extent, the vendors of the mortgages, where they were approved lenders.

11. In dealing with a proposal for the financing of N.H.A. mortgages for new construction, the legality of commitment and standby fees in connection with N.H.A. mortgages becomes an important issue. Obviously at times when funds are available on a long term forward basis without the payment of commitment fees, no such fees would be charged; borrowers wouldn't pay them. However builders always have the freedom of choice between arranging long term forward commitments or just taking such amounts of mortgage money as may from time to time be immediately available and which they can then use. Most large builders questioned on the subject felt that the savings that may be effected by the long term planning permitted under forward commitments, certainly make normal commitment and standby fees worthwhile. Because certain approved lenders would make these larger loans as principals in the first instance, holding them for sale on completion, long

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term forward take out commitments for the large amounts of financing involved are necessary. As with virtually every other kind of financing involving long term commitments, the borrower is normally required to make provision for reasonable commitment and standby fees. Provision for the payment of such fees is essential. If commitments are to be provided for the purchase of completed mortgages for as long as two years in advance, approved lenders must be in a position to collect commitment and standby fees. The amount of such fees will naturally vary with the type of commitment being sought; but in an open competitive market no abuse is possible. Builders and developers are quite willing to pay such commitment fees as are necessary to provide the funds they require. Many builders questioned on the subject feel that they should have the right to decide themselves on this question of commitment and standby fees. The apparent objection to commitment and standby fees is the view that they may be used to increase the yields obtainable on N.H.A. mortgages over the maximum interest rates chargeable. However, the view favouring these charges is that the service performed to the builder in making available forward commitments is one that ought to be recognized as being within the spirit of Regulation 20.

12. It is desirable for private enterprise institutions to be actively involved in secondary market activities in N.H.A. mortgages. However, it may well be said that the existing rules favour only Government activity in this field to the exclusion of private enterprise. Among many opinions on this point which various people have put forth, two

very clear points may be cited:

(a) Trust companies which are not otherwise limited from so doing, are limited by the National Housing Act from making N.H.A. loans as agents for their clients. They must undertake all new N.H.A. loans they make as principals and their ability to do this in volume is limited by their own policies regarding the employment of their capital and credit, which must be employed to finance all their business activities, not just the creation of N.H.A. mortgages. They must hold the N.H.A. loans they do make until completion of all advances. In larger loans it often takes more than a year for a loan to be completed. Only then may they place or sell these loans. If they were free to make loans as agents, they could undertake a large volume of placing loans on behalf of investors who on their own do not, nor are they even qualified, to make N.H.A. loans. Many of such possible investors who are not now involved in N.H.A. mortgages to any great extent, if at all, are of the type that would undoubtedly trade these mortgages from time to time in the future.

(b) With respect to acceptability of title in the event of a default and a claim being made on the Corporation under the insurance obligation, the terms of sale of the mortgages put up for tender by the Corporation are more favourable than those upon which

it is feasible for a private vendor to offer its mortgages for sale. C.M.H.C. in effect warrants title acceptability on their own mortgages. The provisions of Regulation 50 constitute a very cogent technical objection affecting the desirability of N.H.A. mortgages as investments. The fact that this is cured with respect to mortgages offered for sale by the Corporation merely serves to emphasize the objection. It also seems to give these mortgages an unfair advantage in the market over other mortgages which might be available.

At present many mortgage and trust companies dealing in N.H.A. mortgages find it necessary to bolster N.H.A. mortgage portfolios with conventional mortgages, thus losing the advantage of the Government covenant behind a total mortgage portfolio. The only entity apparently able to take advantage of this under the present rules seems to be C.M.H.C.

13. The original objective of the insurance obligation was to influence more private lenders to lend more money on the higher ratio loan to value and longer term mortgages made under the National Housing Act. It is probably fair to say that the 1954 Act introduced the insurance obligation in an effort to have mortgage investors relate their returns on N.H.A. mortgages more closely to yields on comparable term Government bonds than to returns available on conventional mortgages. For normal housing loans the maximum differential of 2¼ percentage points as fixed by the 1954 Act was no doubt arrived at in light of the expected market evaluation of the insurance obligation in relation to government bonds.

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For a period of time after the 1954 Act came into force there was a sufficient flow of funds at the rates of interest from time to time obtaining within the 2¼ percentage point formula. C.M.H.C. was not involved in heavy direct lending. It can therefore be assumed that the initial market evaluation of the insurance obligation was favourable, or at least sufficiently favourable to support a flow of private funds into N.H.A. mortgages adequate to meet the demand in most circumstances. The situation in the last few years has changed. Except for relatively short periods, there has existed for the last few years and, in an overall sense, there exists today a substantial shortage of institutional and other private funds for investment in N.H.A. mortgages. The reasons for this are apparently:

(a) The growing overall shortage of investment capital in relation to demands in an expanding economy for investment capital and hence the competition for it.

(b) A re-evaluation by a large part of the original N.H.A. market of the investment attractions of N.H.A. mortgages in light of comparison with other available investments.

(c) And as a dislocating factor in the emergence of the above pattern, the entry into and then the withdrawal of the chartered banks from the N.H.A. lending field.

(d) The failure to attract sufficient additional and new investment funds either directly or indirectly into the N.H.A. market.

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(d) The failure to attract sufficient additional and new investment funds either directly or indirectly into the N.H.A. market.

One result has been that the Government, in order to help meet the continuing demand for housing, has found it necessary to make direct housing loans at the rate of approximately $250-300 million each year. Another result has been that many projects which might have been undertaken have had to be delayed or forgotten. The amount of direct lending by government must be taken as a major indication of the extent of the overall shortage of funds. The following is a table showing the approximate amounts of money for N.H.A. mortgages by all approved lenders compared with C.M.H.C. since 1955.

Year	Approved Lenders ($000,000)	C.M.H.C. ($000,000)	Total ($000,000)
1955	599	16	615
1956	388	19	407
1957	261	233	494
1958	510	373	883
1959	283	343	626
1960	232	161	393
1961 (est.)	327	275	602
Totals	2,600	1,420	4,020

It is to be noted that since the 1954 Act has been in force there has only been one major improvement in the terms of N.H.A. lending. That improvement was the removal of the so-called "2% bite" or co-insurance feature. Otherwise the insurance obligation has remained substantially the same, although there have been some minor improvements made from time to time in other respects.

14. While there have been variances within the 2¼ percentage point spread in the relationship between the yields on long term government bonds and the fixed N.H.A. interest rate (See Schedule "A") it is difficult to determine whether a higher N.H.A. rate at any particular time would have been sufficient to produce more private funds. It is clearly desirable to keep the

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N.H.A. interest rate down as low as possible. It is also necessary to have the investment of private funds in N.H.A. mortgages keep pace with demand. It would appear that the availability of funds for investment in N.H.A. mortgages is not solely a function of interest rate. Generally, other important factors are:

(a) The market evaluation of the Government insurance obligation,

(b) The terms of lending generally, and

(c) The liquidity of the investment.

This is not a question which is subject to easy analysis. There are a number of institutional investors that originally made N.H.A. loans and who might have been expected to continue and expand their N.H.A. lending activities in a manner comparable to other institutions who have continued active in the field. Four or five institutions only, however, continue their N.H.A. lending activity in any real volume, although there are many lenders in the field. Many institutions who were originally making N.H.A. loans have substantially reduced or ended their N.H.A. lending. At least one of these institutions, which no longer makes N.H.A. loans, has expressed the view that in light of analysis little, if any, value may be attributed to the insurance obligation. It therefore feels that it should get the going conventional rate on the amount of the loan up to the first 2/3rds of the valuation and say 12% per annum on the excess. This would mean an interest rate of around 8½% on a 90% loan. Any institution which is otherwise limited to 66 2/3% loans and conscientiously attributes no value to the insurance

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obligation, should not make any N.H.A. loans. This is exactly what many of these institutions are doing.

15. The view has been expressed that the N.H.A. interest rate as fixed by the Government affects the interest rates set by financial institutions for conventional first mortgage residential lending. This is probably true to some extent. In theory the insurance obligation should result in an interest rate of from 1/4 to 1/2 of 1% less on N.H.A. mortgages than on conventional first mortgages. If there exists a shortage of funds for N.H.A. mortgages, but many lenders still have funds to invest in conventional first mortgages, the conventional rate will tend to stay at from 1/4 to 1/2 of 1% over the fixed N.H.A. rate until the competition for conventional first mortgages drives the rate down. This situation exists only because of the reluctance of lenders to make N.H.A. loans. If there were funds equally competing for N.H.A. loans, that rate would similarly be driven down by competition. The conclusion is that those lenders who remain active, apparently continue to be satisfied with the relationship between government bond and N.H.A. yields or possibly have such a volume of funds for investment that they must take advantage of N.H.A. mortgages as an outlet. But because the lenders who are apparently no longer satisfied with the relationship have substantially gone out of the field, the published statistics do not tell the whole story. And then there is the added complication to any such analysis, that direct government lending has increased. This very substantially affects the usefulness of statistics as an aid to interpret market evaluation. Only if the interest rate on N.H.A. mortgages had been

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free to vary during the period under review, and if there had been substantially less direct lending by the Corporation, would the statistics be of any real assistance in analyzing the question of how the market evaluates the insurance obligation.

16. It seems therefore that the yield available on N.H.A. mortgages is only a really important factor to those investors who either continue to evaluate the insurance obligation favourably or have found some method of providing a cushion against, as they see it, the uninsured risks involved. Even if the rate were free to go to say 8 or 9% or higher, this alone would not necessarily produce the desired funds. For one thing the expected rate of prepayments to permit refinancing at lower rates would discourage institutional lenders from getting heavily involved; for another, larger institutions, for public relations reasons, shy away from high rate loans. But all that is hypothetical because the Government would never permit such rates. The continuing objective is to lower the rates while continuing to attract adequate funds into the market.

17. The question is then what are the factors, other than yield which affect the attractiveness of N.H.A. mortgages as investments. This question has been discussed with a number of investment officers at various times. The experienced mortgage investment officers approached the question in a different way than did other investment officers, but amongst all there was a divergence of view as to the most important factors. The following is a list of the factors most often mentioned, but because of the divergence in the views obtained, no particular order of priority has been attempted:

(a) There is the possibility that in the future the Corporation might attempt to avoid its obligation to pay under the Mortgage Loan Insurance Policy because of title unacceptability. This could come about notwithstanding that the mortgagee had taken all reasonable precautions, including the retaining of competent and experienced solicitors at the time the mortgage loan was made. Regulation 50 states that the Corporation will accept title, which is satisfactory in "the opinion of leading solicitors and notaries generally in respect to the community in which the property is situate". This is a test which is difficult and impracticable to apply and no procedure is laid down in the Regulations to cover the problems of application. In the event of any dispute the legal test of responsibility ought to be the law of the province in which the property is situate. The Regulations should contemplate the taking of any available court proceedings to establish title acceptability in the event of a dispute.

(b) Even if the mortgagee has caused to be made a proper investigation of the title to the mortgaged premises at the time that the mortgage loan is made, future changes in the law respecting the validity of titles could very well relieve C.M.H.C. of its obligation to pay under the insurance obligation. This does not raise the question of moratorium type legislation, but rather changes in law (e.g. an appeal court reversing a previously accepted lower court decision) after the loan has been made. So long as the lender did everything a prudent lender should have done when making the loan and its solicitors have dealt with any title questions on the basis of the law as it then was, the lender should not be

(a) There is the possibility that in the future the [illegible] [illegible] [illegible] about notwithstanding that the mortgagee had taken all reasonable precautions, including the retaining of competent and experienced solicitors at the time the mortgage loan was made. Regulation 30 states that the corporation will accept [illegible] "the opinion of leading solicitors and notaries generally in respect to the community in which the property is situate". This is a test which is difficult and impracticable to apply and no procedure is laid down in the Regulations to cover the problems of application. In the event of any dispute the legal test of responsibility ought to be the law of the province in which the property is situate. The Regulations should contemplate the taking of [illegible] acceptability in the event of a dispute.

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penalized by future changes in the law over which it has no control. The lender obviously cannot subsequently release or otherwise impair or alter the security (except as permitted by Regulation 41) but it should be protected if it has taken the usual careful precautions. If the insurance obligation is to assist in making the mortgage more tradeable, the point in time when title acceptability should be relevant is when the mortgage was made.

(c) In modern techniques of development and subdivision there is often included the imposition of various kinds of restrictions and limitations. Items questioned in this area, as well as other title questions may well come within the class of approved title defects or they may fall outside of them, in which case it is necessary to establish their acceptability. The method of establishing the acceptability or inclusion of approved title defects can be substantially improved so as to provide lenders with a responsible degree of certainty covering questions of title.

(d) Section 7 of the Act states that a loan is insurable if it is made under some one or more of the provisions of that section and also "on such terms and in accordance with such conditions in addition to those specified in the preceding paragraphs as may be designated by regulation." Some experienced mortgage investment people wonder if a building can ever be completed in full technical compliance with the Regulations. Certainly there is no practical way for a mortgagee to satisfy itself on this point. Inspectors employed by C.M.H.C. make their normal checks during the progress of construction, but

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(e) The cost of putting an insured loan on a mortgagee's books usually exceeds the cost of putting a conventional loan on the mortgagee's books and there are more administration, forms, etc. involved.

(f) The repayment privileges permitted under N.H.A. mortgages are more liberal than normally extended in conventional lending. This has been partially remedied by an amendment which permits multiple housing loans by corporate borrowers to be non-prepayable during the first ten years.

(g) In the insurance settlement, provision is made for the payment of interest at the mortgage rate for a six month default period. In many provinces established mortgagors' rights make the completion of foreclosure proceedings within six months almost impossible. If the mortgagee conducts his collection and realization proceedings in accordance with ordinary prudence and with all due despatch, it would seem reasonable that interest at the full rate should continue to be insured. Lenders would accept a reasonable period, but six months is not

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equity, is desirable. This is the theory behind the concept of institutions which will deal in and hold only N.H.A. mortgages and sell securities to finance the holding of such a portfolio. These securities should prove not only attractive to investors who would unlikely make direct investments in N.H.A. mortgages under any circumstances, but also to certain larger investors and the public who have little mortgage investment experience. One very important aspect of this type of financing is that it removes from the investor all responsibility for and concern about the administration of the mortgages. Also, it provides a cushion for possible future excessive foreclosure and other unexpected expenses. More importantly, the creation of a tradeable instrument permits a high degree of liquidity not available in direct mortgage investments. Such a form of security may prove so attractive as to lead to lower interest costs on the N.H.A. mortgages themselves.

19. The object of the legislation ought to be to facilitate the situation in Canada where the most possible investors have the freedom and incentive to invest and trade (directly, or indirectly via securities) in N.H.A. mortgages. The objective should be to provide a constant flow of private funds competing for the opportunity to invest in N.H.A. mortgages. It is then possible for the capital market to dictate satisfactory interest costs in light of the investment character and liquidity of the mortgage with little or no, or perhaps only periodic or special situation government regulation, interference or competition. It is therefore suggested that a new stimulus be given to private participation in N.H.A. lending; a stimulus which will cause private capital to re-evaluate the whole investment relation-

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20. There are, then, two basic conditions for a successful secondary market operation in N.H.A. mortgages: (1) rules which facilitate the easy and orderly direct trading of mortgages, and (2) the existence of some form of liquid and marketable security which will facilitate the easy and orderly indirect investment in and trading of mortgages. If these two conditions exist, then it follows that there will be substantially more lenders with substantially more money regularly available for investment in N.H.A. mortgages. Significant is the fact that a broader group of more active lenders will be interested in and competing for investments in a much broader scale of N.H.A. mortgages than is now the case. This will be important not only to buyers of single family homes, but also to the builders and developers and future occupants of various kinds of multiple housing projects.

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21. By removing the objections which apparently loom large in the minds of many investors, a whole chain reaction of events logically follows. As stated, there will be more money from more lenders. This will mean that there will be competition for the available loans, rather than the periodic acute shortages of funds. Competition for loans will result in the market governing the interest rates, which will then tend to fall without direct regulation. Interest rates, being realistically related to the whole capital funds market, will more closely follow bond rates. Central bank control of and influences on the national financial situation will then affect all segments of the economy more evenly. Housing need not be singled out for special control, but the special implements of control and influence in the mortgage field may be retained for use only in special circumstances. Heavy direct lending by government ought only to be used as a stop-gap measure, but a continuation of the recent trend would soon establish it as an accepted method of financing residential construction. It is quite clear that the development of strong secondary market activity will relieve the Government of the necessity of being a heavy direct lender of funds and will provide over the years an opportunity to the Government to sell a substantial part, if not all, of its portfolio of ordinary housing loans.

22. In a nation whose strength arises from the independent spirit of its people, it is distressing to have a governmental agency as the largest mortgagee and hence potentially the largest landlord. In the areas of housing and the financing of housing, there are tremendous fields of operation for government directly and via C.M.H.C., other than that of supple-

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menting the various private means of raising capital. One of these areas of operation is surely assisting in creating the investment climate in which the various private means of raising capital are used to full capacity. It is not advocated that C.M.H.C. either immediately or ultimately, completely withdraw from the field of direct lending. It should continue direct lending in outlying areas where it is unable to persuade private lenders to go or where it thinks private terms too difficult for the borrowers. It should continue to have the facility to make loans in periods of tight money, unemployment and in other situations where direct lending is necessary and desirable, but the exercise of this function ought to be substantially less necessary and certainly should be used more sparingly. The Corporation's resources would then be more available for the extremely important special government undertakings of public housing, housing for elder citizens, university residences and the various other desirable items that are often more effectively undertaken by government than by private financial institutions. The housing requirements of the future, at least for the next ten years, appear to be in the neighbourhood of 125,000 to 150,000 units per year. This means that from $600 to $900 million of mortgage funds insured under the National Housing Act will be sought each year. From all present indications the participation of private capital in mortgage finance under the Act will not keep pace with these requirements. It seems essential therefore that steps be taken to irradicate the reluctance of investors to go into N.H.A. mortgage investments.

23. The following recommendations for Governmental action are submitted for the consideration of this Commission:

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23. The following recommendations for Governmental action are submitted for the consideration of this Commission:

1. Amend Regulation 50 to provide that the Corporation will not, in an insurance claim settlement, object to title if it was satisfactory under the law of the province in which the mortgaged premises are situate at the time when the mortgage loan was made. (Reference herein is made to Schedule A hereto).

2. Amend Section 9 of the Act to provide for inclusion in the insurance settlement of interest at the mortgage rate for a longer period so long as realization proceedings are being prosecuted with due despatch. Also provide for the contribution to the costs of realization on a basis which will offer, particularly to smaller lenders, less risk of bearing unusually large costs which may well arise out of circumstances beyond their control. (Reference is made to Schedule A hereto).

3. Amend Sections 3 and 6 of the Act and Regulation 47 to provide that approved lenders may make N.H.A. loans as agents for investors. (Reference is made to Schedule A hereto).

4. Amend Section 7 of the Act to provide that the issuance of the insurance policy estopps the Corporation from subsequently relying on building or procedural defects incurred prior to the issuance of the policy to avoid the obligation to pay under the policy. (Reference is made to Schedule A hereto).

5. Amend Regulation 20 so as to clarify that reasonable commitment and standby fees may be collected by an approved lender. (Reference is made to Schedule A hereto).

6. Direct that C.M.H.C. be permitted to negotiate for

1. Amend Regulation 50 to provide that the Corporation will not, in an insurance claim settlement, object to title if it was satisfactory under the law of the province in which the mortgaged premises are situate at the time when the mortgage loan was made. (Reference herein is made to Schedule A hereto).

2. Amend Section 9 of the Act to provide for inclusion in the insurance settlement of interest at the mortgage rate for a longer period so long as [illegible] due despatch. Also provide for the contribution to the costs of realization on a basis which will [illegible] of bearing unusually large costs which may well arise out of circumstances beyond their control. (Reference is made to Schedule A hereto).

3. Amend Sections 3 and 6 of the Act and Regulation 47 to provide that approved lenders may make N.H.A. loans as agents for investors. (Reference is made to Schedule A hereto).

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5. Amend Regulation 20 so as to clarify that reasonable commitment and standby fees may be collected by an approved lender. (Reference is made to Schedule A hereto).

6. [illegible] C. be permitted to negotiate for

the sale of mortgages from its portfolio, even although certain aspects of the tender system are preserved as to price. Have C.M.H.C. in a position to deliver mortgages in sufficiently large packages (as well as in smaller ones) that as many potential buyers as possible can be satisfied. Rather than the flat fee servicing basis upon which C.M.H.C. is prepared to service mortgages, have them prepared to negotiate servicing contracts that are competitive with other approved lenders.

24. In addition to the foregoing, the whole question of chartered bank participation in N.H.A. lending and secondary market activity in N.H.A. mortgages should be reviewed. Some of the banks have recently come back into the N.H.A. lending business in a relatively small way through trust companies. It seems logical that others may follow, particularly if an active and responsible secondary market were in operation. Because perhaps up to 3,500 of the 5,500 odd bank branches throughout the country could actively function as mortgage outlets and mortgage servicing offices, it is desirable to have broad chartered bank participation in the N.H.A. lending program. Our chartered bank branch system is unique in its facility to participate in and serve the N.H.A. mortgage lending business. In addition to their physical and personnel attributes, they exert a large sphere of influence in investment matters. If banks could make and service loans as agents, they could from time to time introduce new funds of others, as well as their own, into N.H.A. lending and they could assist others in the creation and servicing of new loans. Their servicing facilities would also be available on a competitive basis in secondary market activities.

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25. It seems that the reluctance on the part of the banks to participate directly in new lending might well be overcome by an amendment to the Bank Act, comparable to the amendment of several years ago to the Canadian and British Insurance Companies Act, confirming the legality of N.H.A. mortgages as investments. Notwithstanding the specific authority, as set forth in Section 3 of the National Housing Act, to approved lenders to make N.H.A. mortgages, the Canadian and British Insurance Companies Act does specifically make N.H.A. "legal for life without resort to the basket provisions". It would seem appropriate therefore to amend the Bank Act in a comparable way. This would then free those chartered banks who are doing their N.H.A. lending activities through trust companies to do them directly, if they so chose. It would undoubtedly lead to a growing bank participation in N.H.A. lending activity without further consideration of the somewhat, at least to the layman, confusing question of banks lending money at rates in excess of 6% per annum. If some banks were to recommence their direct participation in the N.H.A. lending program, others would be bound to follow. The question of the power of approved lenders to make N.H.A. loans as agents, rather than solely for their own account as principals, is given additional importance and urgency when the participation of banks is considered. Their ability to assist in and finance the creation of new loans on behalf of various classes of investors is substantially simplified, and their authority for so doing clarified, if the power of approved lenders to make loans as agents is specifically spelled out in the Act.

26. A responsible secondary market in N.H.A.

mortgages depends upon active trading, either direct trading of mortgages or trading of securities backed by mortgages. The banks have substantial portfolios of mortgages which, if competitively qualified in the market, would be bound from time to time to find their way into the market. To the extent this occurred it would produce funds in the hands of banks for new lending. Liquidity has always been an important factor in the investment programs of many, but particularly of banks. The establishment of a responsible and active secondary market for N.H.A. mortgages would certainly provide the desired degree of liquidity and would strongly influence wide participation by banks in secondary market and new N.H.A. money activities. It is therefore recommended that the Government give serious consideration to having all amendments apply to all mortgages made under the 1954 Act, including the removal of the 2% co-insurance feature. Such action would put all N.H.A. mortgages on an equal footing for trading, except for interest rates and maturities, as is the case with government and other bonds. By reason of the fact that loans made with the 98% insurance feature have been in existence for some time and have had several years of payments made thereon, the added contingent liability to the insurance fund for making this move would likely prove nominal.

27. As stated, it is not recommended that C.M.H.C. should withdraw from direct lending entirely. There will undoubtedly continue to be periods of time and geographic locations where direct lending will continue to be desirable in the national interest. In supplement to governmental direct lending activity, it is recommended that the basis of direct lending be

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broadened and made more flexible by the introduction of special loans to approved lenders. Such loans should be available on terms which will provide an incentive to approved lenders sufficient to induce them to make mortgage loans which they would not otherwise make. Primarily the incentive should be lower interest costs designed to compensate for additional servicing costs. The joint loans that were made prior to the 1954 Act also provide an indicated method which proved successful in the past. It is desirable to have as many methods of providing financing for the making of N.H.A. loans as possible in order that the various requirements of as many sources as possible may be met. On this vein it should be noted that it is desirable to have the country's investment dealers brought into the N.H.A. mortgage market activities on a better basis than is now available to them. It is my contention that investment dealers are more effective at dealing in securities than in mortgages and that therefore they would best serve N.H.A. mortgage secondary market activity by selling securities based on mortgages. However, they should not be limited to this field. If C.M.H.C. could make commitments to be a buyer of last resort of N.H.A. mortgages held by investment dealers, then with confidence they could take on more mortgages and hold them for sale. This would similarly apply to companies set up to deal only in N.H.A. mortgages. Temporary banking accommodation would be more readily available until an issue of securities could be marketed. On the several tenders to date of mortgages for sale by C.M.H.C., on many of the parcels there have been a number of bidders. It seems quite apparent that a system of negotiated sales could be established to fill the requirements

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of many of these unsuccessful bidders. This is not now available under the tender system in force.

28. With respect to the technical aspects of securities of companies dealing only in N.H.A. mortgages, it is desirable that such securities be qualified as investments in which companies registered under the Canadian and British Insurance Companies Act may invest their funds or any portion thereof, without availing themselves for that purpose to the provisions of section 63(4) of that Act. The collaterally secured obligations of such companies are saleable, of course, on the basis that they are secured by the pledge of the portfolio of N.H.A. mortgages. However, the basis of the opinion must rest on irrelevant provisions of the Act, such as Section 63(1)(j)(i)(A), even although it has no relation to the main security. The reason for this is that for the collaterally secured obligations to come within sub-section (h) they must be "fully secured". All counsel canvassed on this matter agreed that this contemplates the registration of assignments of mortgages, trust deeds, supplementals, etc. against the title to every mortgage acquired. Such registrations are, of course, expensive and not feasible; hence the legality, for opinion purposes, must rest on technical qualification within a section not relevant to the business aspects of the financing. Because of the foregoing, a group desirous of entering this field acquired a company which was a suitable vehicle by virtue of its having paid the stated rate of dividend on its preferred stock for more than five years. Some qualification to this legislation which would permit greater flexibility in the organization of companies for secondary market operations is clearly desirable.

29. Not only can the various sources and methods abovementioned produce adequate funds for the secondary market activity, but they can produce sufficient funds so that there will be competition for new loans. This is bound to reflect in the interest charges on N.H.A. mortgages and tend to lower them. It is, therefore, most desirable that all those various factors be brought into play. When they have, as a second step, it is recommended that the Government free the interest rate chargeable on N.H.A. mortgages, because regulation should no longer be necessary. The main regulating factors then, would be current yields on Government bonds from time to time and special situation servicing costs. This should prove not only satisfactory to the market, but desirable from many standpoints. When investors come to relate the return on their direct or indirect investments in N.H.A. mortgages to the yields on government bonds, the spread will be narrowed and fluctuations confined within closer limits.

30. The foregoing are thoughts and recommendations with respect to a purely Canadian secondary market in N.H.A. mortgages. This is not to say that foreign investment capital would not from time to time be employed therein; no doubt such a money requirement would likely often look beyond our borders for satisfaction. However, the thoughts outlined are developed from and applied to the indicated pattern of development of our legislation, our financial institutions, our housing requirements and our national needs. The U.S. pattern of providing F.H.A. and V.A. mortgage loans is now briefly outlined in order to emphasize the differences in our respective overall situations as they have developed in this field. Under the United States

National Housing Act, the Federal Housing Administration (F.H.A.) insures single family, multiple family and many special assistance housing programs, including redevelopment, renewal, college housing, housing for the elderly, nursing homes, etc. Applications for these loans are made in a way comparable to the application for a Canadian N.H.A. loan. The significant difference is that the fixed interest rate is not protected. Loans may be made at a discount. A builder having obtained F.H.A. approval of his subdivision applies to F.H.A. through a local mortgage banker for an undertaking to insure. When this undertaking has been received, the mortgage banker (or broker) will arrange to place the loan with a savings and loan association, life insurance company, etc. at a price. If this price is less than par, and most often it is, this discount is passed to the builder. The mortgage banker may not seek an institutional commitment to take up the loan on completion at the outset, but may carry it in its portfolio. In this case, it usually seeks from The Federal National Mortgage Association (F.N.M.A.) a standby commitment for purchase on completion. Such a commitment is normally from 1/4 to 1/2 of 1% under market and, of course, will be taken up if the market has worsened prior to completion of the mortgage and its availability for delivery as a completed loan. F.N.M.A. operates as a government agency stabilizing the mortgage market by purchasing and selling F.H.A. loans. On balance, it is a larger purchaser in that it issues its own obligations to the public and to the Treasury Department, the latter particularly in connection with special assistance programs which are financed at lower interest rates than are marketable

National Housing Act, the Federal Housing Administration (F.H.A.) insures single family, multiple family and many special assistance housing programs [illegible] housing, housing for the elderly, nursing homes, etc. Applications for these loans are made in a way comparable to the application for a Canadian N.H.A. loan. The significant difference is that the fixed interest rate is not protected. Loans may be made at a discount. A builder having obtained F.H.A. approval of his subdivision applies to F.H.A. through a local mortgage banker for an undertaking to insure. When this undertaking has been received, the mortgage banker (or broker) will arrange to place the loan with a savings and loan association, life insurance company, etc. at a price. If this price is less than par, and most [illegible] The mortgage banker may not seek an institutional commitment to take up the loan on completion at the outset, but may carry it in its portfolio. In this case, it usually seeks from The Federal National Mortgage Association (F.N.M.A.) a standby commitment for purchase on completion. Such a commitment is normally from 1/4 to 1/2 of 1% under market and, of course, will be taken up if the market has worsened prior to completion of the mortgage and its availability for delivery as a completed loan. F.N.M.A. operates as a government agency stabilizing the mortgage market by purchasing and selling F.H.A. loans. On balance, it is a larger purchaser in that [illegible] the Treasury Department, the latter particularly in [illegible] finance at lower interest rates than are marketable

(i.e. 3-3/8% - 40 years). The F.H.A. guarantee in the event of default pays in 20 year Debentures bearing an interest rate, which is set at a rate comparable to the market rate of outstanding 20 year Government bonds at the time of guarantee of the mortgage and carrying the unqualified guarantee of the U.S. Government. F.N.M.A. purchases F.H.A. mortgages at a discount, currently 95 - 96 - 97 to par for special assistance programs, and requires the seller to purchase common stock in F.N.M.A. to the extent of an additional 1%, thus increasing its paid-in capital as it acquires mortgages. It is currently paying a dividend of $3.24 per share annually and its stock is currently selling at about 84. Its general obligations, which are not guaranteed by the U.S. Government, mature in from six months to fifteen years and currently yield 2.76% to 4.09%. Due to its acquisition of mortgages yielding about 5.25% (face rate 5-1/4 less 1/2% servicing, purchased at 96, equals approximately 5.25% yield) and selling its obligations at substantially less, F.N.M.A. has a profitable operation. When the market for F.H.A. loans improves, F.N.M.A. sells its mortgages in an orderly manner to permanent institutional investors at prices somewhat over its initial purchase price, thus acting as a balance in the market. Currently, it is offering its F.H.A. single family loans bearing 5-1/4% interest at 99. In 1960 F.N.M.A. sold from its portfolio almost as many "seasoned" loans as it acquired in new loans. In 1961 it purchased several hundred million more than it sold. The mortgage market is now improving so that F.N.M.A. will again be a substantial seller of loans in 1962. Other "converters" of F.H.A. mortgages into other forms of obligations are

savings banks, savings & loan associations, commercial banks, through their time deposits, and more recently real estate mortgage investment trusts. Several such trusts have recently been formed, but all are based on the idea of substantially higher returns to the investor than the face rate of the mortgage, which is accomplished by borrowing on collateralized loans at lower interest rates and making uninsured land development loans and construction loans. Since no guarantees are made by these trusts and since they have so far been sold on the expectation of a higher, more speculative return, their affect on the mortgage market is still unknown.

Respectfully submitted,

John R. Campbell

TORONTO, April 13th, 1962.

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[illegible]

[illegible]

John H. Campbell

[illegible]

SCHEDULE A

1 It is recommended that Section 50 of the National Housing Loan Regulations be amended to read as follows:

"50. The Corporation may, at its own expense, cause a search to be made of the title to the property and shall, within thirty days of the receipt of a claim, notify the approved lender whether or not it has any objection to the adequacy of title, provided that the Corporation shall not object to the adequacy of such title if at the earlier of the date upon which the insured loan on the property was fully advanced or the date upon which the policy of mortgage loan insurance was issued, the title to the property was, in accordance with the law, as it then was, of the province or territory in which the property is situate, good and marketable without defects, or good and marketable subject only to any or all of the following defects:

(1) Defects in title specified or to be specified in the policy of mortgage loan insurance.

(2) Defects comprising some one or more of the following:

(a) Violations of size, cost, setback or use restrictions which do not provide a penalty of reversion or forfeiture of title, or a lien for liquidated damages which may be prior to the insured mortgage. Violations of such

restrictions which do provide for such penalties, provided such penalty rights have been duly released or subordinated to the insured mortgage.

(b) Violations of a municipal restriction on size, cost, setback or use that are common to the neighbourhood in which the mortgaged property is situated, provided that the Clerk of the municipality confirms that the violations have been common and that the municipality has not taken action in respect of such violations.

(c) Violations of a restriction on ownership or occupancy based on race, color, creed or national origin.

(d) Easements, servitudes or reservations for public utilities along one or more of the property lines and extending not more than 10 feet therefrom and for drainage or irrigation ditches along the rear 10 feet of the property, provided the exercise of the rights thereunder do not interfere with any of the buildings or improvements located on the mortgaged property.

(e) Easements, servitudes or reservations for underground conduits that do not extend under any buildings on the mortgaged property.

(f) Mutual easements, servitudes or reservations for joint driveways constructed partly on the mortgaged property and

partly on adjoining property, provided the agreements creating such easements are of record.

(g) Encroachments on the mortgaged property by improvements on adjoining property where such encroachments do not exceed 1 foot, provided such encroachments do not touch any buildings or interfere with the use of any improvements on the mortgaged property.

(h) Encroachments on adjoining property by eaves and overhanging projections attached to improvements on the mortgaged property where such encroachments do not exceed 1 foot.

(i) Encroachments on adjoining property by hedges, wooden or wire fences belonging to the mortgaged property.

(j) Encroachments on adjoining property by driveways belonging to the mortgaged property where such encroachments do not exceed 1 foot, provided there exists a clearance of at least 8 feet between the buildings on the mortgaged property and the property line affected by the encroachment.

(k) Variations between the length of the mortgaged property lines as shown on the application for insurance and as shown by the record or possession lines, provided such variations do not interfere with the use of any of the improvements on the mortgaged property and do not

involve a deficiency of more than 2% with respect to the length of the front line or more than 5% with respect to the length of any other line.

(l) Encroachments by garages or improvements other than those which are attached to or a portion of the main dwelling structure over easements for public utilities, provided such encroachment does not interfere with the use of the easement or the exercise of the rights of repair and maintenance in connection therewith.

(m) Reservations of coal, petroleum, gas or mineral rights.

(n) Liens or charges on the property for accruing provincial income taxes or municipal realty taxes, rates, charges, assessments, local improvement rates or assessments, including school, ecclesiastical and other general or special taxes, or instalments on account thereof, not due at the earlier of the date upon which the insured loan on the property was fully advanced or the date upon which the mortgage loan insurance policy was issued.

(3) Defects comprising easements, restrictions, reservations or encroachments, not coming within the classes of defects enumerated under subsection (2), as would not be violated by the construction on the property of a house or multiple family dwelling in accordance with conditions under which the insured loan thereon was made or by the reasonable use of the property for residential purposes.

The approved lender, at its option and within ninety days, or such longer period as the Corporation may approve, from the receipt by it from the Corporation of notice of objection to the adequacy of title, shall either satisfy the objection or withdraw the claim, provided that the approved lender may not be required to withdraw the claim so long as any proceedings as to the adequacy of title are outstanding in or before any court, master of titles or land registrar of competent jurisdiction. The Corporation may appear in any such proceedings and if the law of the province in which the property is situate permits, may be a party to such proceedings. The Corporation shall not object to any defect in title arising subsequent to the earlier of the date upon which the insured loan was fully advanced or the date upon which the policy of loan insurance was issued so long as such defect is not consequent upon any act of the approved lender."

While the foregoing revision of Regulation 50 would regularize the contents of C.M.H.C. Advice No. 43 into the Regulations and is strongly recommended as establishing an acceptable procedure for meeting some of the serious difficulties experienced under the present legislation, it is not the best solution to the problems raised. The best solution would be one which promoted secondary market activities. Under either the present or the above proposed scheme of dealing with title questions, subse-

quent purchasers of mortgages must still investigate and be satisfied with the title to each mortgage purchased. Hence the foregoing suggestion, while solving certain existing inconsistencies, does not attempt to promote secondary market activities. The only other presently available solution is for the seller of the mortgages to warrant title. Institutions seldom warrant title to properties they sell, hence in most instances separate title opinions are necessary. Warranting titles may be a satisfactory method of dealing with isolated transactions, but it will prevent any real activity in a secondary market.

Obviously, to make an N.H.A. mortgage freely tradable, the adequacy of title for Section 50 purposes should be established at the time the policy is issued. The only title item then which would remain outstanding during the term of the loan would be defects consequent upon the acts of an owner of the mortgage and these would not only be easily ascertainable, but also they are completely within the control of the owner of the mortgage. Although the carrying out of this suggestion may add somewhat to the administrative tasks of C.M.H.C., the consequent beneficial results to the development of a secondary market would completely justify the move. It is therefore strongly recommended that C.M.H.C. be requested to study methods of implementing this latter suggestion. In the meanwhile the within suggested revision of Section 50 of the Regulations would provide a very substantial and beneficial improvement over the existing situation.

2. It is recommended that clause (d) of sub-section (1) of Section 9 of the National Housing Act, 1954 be amended to read:

"(d) where the default period in respect of any amount specified in paragraphs (a), (b) or (c) is in excess of six months, additional interest at the mortgage interest rate on each such amount for the shorter of:

(i) the period of such excess, or

(ii) a period of eighteen months, if after the mortgage account had gone into default in an amount equal to three monthly payments of principal, interest and taxes where the loan is repayable monthly or in an amount equal to the quarter-ly, semi-annual or annual payment where the loan is repayable quarter-ly, semi-annually or annually, the approved lender holding or adminis-tering the loan, within the time prescribed by regulation, notified the Corporation of such default and took such steps in respect of such account as were satisfactory to the Corporation, provided that where the default period exceeds six months and in the opinion of the Corporation the person holding or administering the insured loan has not actively and with due despatch pursued the reme-dies available at law and under the mortgage, the Corporation may reduce

by two percentage points the amount of interest payable under this paragraph for the whole or any part of the period in excess of the first six months; and"

and that clause (e) of subsection (1) of Section 9 of the Act be amended to read:

"(e) an acquisition fee of one hundred and fifty dollars and such legal fees and disbursements as either:

(i) may be approved by the Corporation and acceptable to the approved lender, or

(ii) in respect of the foreclosure proceedings, have been taxed or otherwise fixed by the court, or a competent officer thereof, having jurisdiction in the foreclosure proceedings as the costs of such proceedings collectable by the approved lender from the mortgagor;"

3. It is recommended that Section 3 of the Act be amended by the addition to subsection (a) of the words "either as principal or agent" so that the subsection, as amended, will read as follows:

"(a) in accordance with this Act, either as principal or agent, make approved loans on the security of a first mortgage in favour of the lender;"

It would also be necessary to provide specifically that construction progress loans being made under the Act by an approved lender as agent

would be deemed to be insured loans. It is therefore recommended that subsection (3) of Section 6 of the Act should be amended to read:

"(3) When an approved loan is made by an approved lender, either as principal or agent, by instalments and the lender has requested that the instalments be insured under this Act, the aggregate of the instalments approved by the Corporation shall, if the insurance fee in respect thereof has been paid, at the request of the lender issue to the lender or, if the loan is being administered by an approved lender in accordance with the regulations, issue to the person for whom the loan is made, an insurance policy in respect of the loan."

The foregoing would recognize that approved lenders, so long as they have the power under the relevant legislation affecting them, may make N.H.A. mortgage loans as agents for others.

It is further suggested that Section 47 of the Regulations as it now reads become Section 47(1) and that a new subsection (2) be added as follows:

"(2) Where an approved lender is prepared to make an approved loan as agent for any person other than an approved lender, the approved lender acting as agent shall agree with such other person to advance and administer the loan, or to arrange for another approved lender to administer the loan, until its maturity in accordance with the Act and these regulations and to carry out

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Section 6 of the Act should be amended to read:

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such administration in accordance with normal mortgage practice.."

4.. It is recommended that Section 7 of the Act be amended by the addition of subsection (4) as follows:

"7(4) Notwithstanding anything in this Section, after the Corporation has issued an insurance policy in respect of a loan, such insurance policy shall not cease to be in force by reason of the loan ceasing to be insurable within the meaning of subsection (1), but shall cease to be in force only if:

(i) it was obtained by fraud on the part of the borrower;

(ii) it ceases to be administered by an approved lender;

(iii) the right of recovery under the mortgage securing the loan ceases to exist other than by reason of the acquisition by the person holding or administering the loan, of the mortgaged property after default has occurred under the mortgage;

(iv) the approved lender holding or administering the loan fails, after default has occurred under the mortgage, to claim payment from the Corporation within the time prescribed by regulation;

(v) a default occurs under the mortgage and title is not conveyed to the

Corporation within the time prescribed by regulation."

5. It is recommended that subsection (1) of Section 20 of the Regulations be amended by the addition of the following clause:

"(e) Where the borrower is a corporation, reasonable standby fees, commitment fees and other financial charges incurred in arranging the insured loan."

Then unless subsection (2) of Section 20 of the Regulations is deleted in its entirety, it would have to be amended to reflect the above, by the addition of the following words:

"except as permitted under paragraph (e) of subsection (1)."

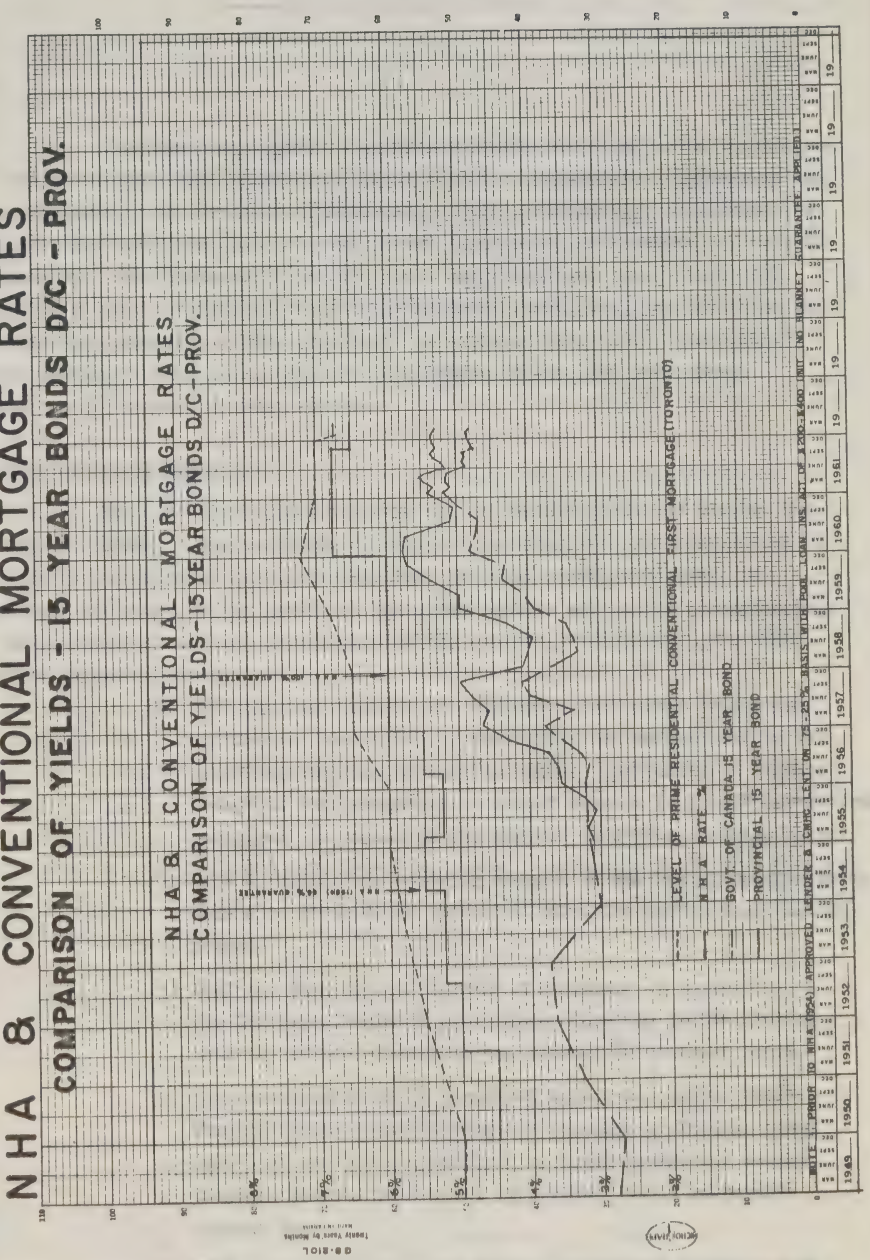
Dealing further with subsection (2) of Regulation 20, it should be noted that Section 7 of the Act states that a loan is insurable if, inter alia, it was made on such terms and in accordance with such conditions............. as may be prescribed by regulation. Then Regulation 20(2) states "It is the spirit and intent of this section that ....".

From a lawyer's point of view, it is difficult to give a legal opinion on whether a loan is insurable when confronted with this kind of language. The language is so broad that it could theoretically affect the situation where the same borrower is obtaining both N.H.A. and conventional mortgages from the same lender.

It would seem that the real control of possible abuses of Regulation 20 is contained in subsection

(3) of the Regulation, where the Corporation is given the right to refuse to issue an undertaking to insure. The effectiveness of this control lies largely in the co-operation given to C.M.H.C. by the approved lenders. It is suggested that C.M.H.C. might, by an advice to approved lenders, make its position on Regulation 20 quite clear. It should do this after complete discussions with Montreal Trust Company and The Royal Trust Company who are the only two approved lenders with both knowledge of and experience in this phase of N.H.A. mortgage lending.

It is therefore recommended that subsection (2) be deleted in its entirety from Regulation 20.


NHA & CONVENTIONAL MORTGAGE RATES
COMPARISON OF YIELDS - 15 YEAR BONDS D/C - PROV.
NHA & CONVENTIONAL MORTGAGE RATES
COMPARISON OF YIELDS-15 YEAR BONDS D/C-PROV.
LEVEL OF PRIME RESIDENTIAL CONVENTIONAL FIRST MORTGAGE (TORONTO)
N H A RATE %
GOVT. OF CANADA 15 YEAR BOND
PROVINCIAL 15 YEAR BOND
8%
7%
6%
5%
4%
3%
2%
1949
1950
1951
1952
1953
1954
1955
1956
1957
1958
1959
1960
1961

March 13th, 1962.

BRIEF OF THE URBAN DEVELOPMENT INSTITUTE (ONTARIO DIVISION) TO THE ROYAL COMMISSION ON BANKING AND FINANCE IN CANADA

1. The Urban Development Institute (Ontario Division) is an association of Land Developers and Consultants in the fields of subdivision engineering and town planning in the Province of Ontario. Further information concerning the purposes for which the Institute was formed is attached as Appendix "A" to this submission. The Members of the Institute, among whom are some of the most experienced land developers, consulting engineering and town planning firms in the province, appreciate the opportunity to express their views before this Royal Commission because of the vital importance to the land development industry of the subject under review.

SUMMARY OF RECOMMENDATIONS:

2. The land development industry has an essential role to play in the economy of Canada. The provision of suitable building lots for residential, commercial and industrial purposes has had, and will continue to have, an important influence on the growth of our urban centres and on the strengthening of our economy through the development of our national resources. For these reasons we wish to recommend:

(1) THAT the down payment for NHA loans be reduced through an increase in the maxima by regulation and an increase in the percentage of loan to lending value. Similarily, a further change in the Insurance Act should be made to permit conventional mortgages in excess of the current 66 2/3% of lending value.

(2) THAT to reduce the carrying charges on NHA loans, consideration should be given to an effective extension in the amortization period.

(3) THAT the Bank Act be amended if necessary to permit the Chartered Banks to participate directly in NHA lending activity without regard to the current 6% interest limit.

(4) THAT municipalities be permitted to borrow capital funds through the National Housing Act in order to install other municipal services in addition to trunk sewers and sewage disposal plants, on a local improvement basis re-payable through taxes.

(5) THAT consistent long-term Federal Government policies with respect to the financing of land development and housing be devised so as to ensure a healthy and continuing investment climate.

GENERAL COMMENTS:

3. The experience of the Federal Housing Authority in the United States, where Government mortgages are made available on the basis of a higher proportion of market value, with concomitant reductions in down payments, would suggest that a similar practice could be followed in Canada. The National Housing Act Regulations should, therefore, be reviewed if they are intended to serve their original purpose.

4. Despite the intention of mortgage lending under the National Housing Act to permit Canadians to borrow funds at low interest rates in order to build or purchase new homes, this purpose is not being served to-day. For example, in Metropolitan Toronto it is impossible for a Canadian with a salary of $5,000. per annum - which is considerably in excess of the average income in Canada - to purchase a new home under NHA Regulations. Similar difficulties are experienced in all urban areas. This situation results, largely, from the increased cost of building lots through demands by municipalities for the installation of pre-paid services by the developer. The latter, in order to recover his costs, must include them in the sale price of the serviced lot.

5. The Gordon Report on Canadian Economic Prospects suggested that new housing in Canada would be required at a basic rate of 125,000 per annum. Such a programme could involve mortgage fund requirements at a rate in excess of 800 million dollars per annum. For these reasons, land development which of necessity sparks the house-building industry - representing more than 20% of all fixed capital in the country - has become and will continue to be one of the most important industries in Canada. In the tradition of private enterprise by which this country was able to grow, the land developer has always been an entrepreneur. As such, he buys land, employs professional assistance, risks his capital and provides the personal drive necessary to co-ordinate his development project before selling in the normal fashion of business economics. However, to operate successfully, an entrepreneur must be assured of long term money commitments. This point was recognized in the report published recently by the Royal Architectural Institute of Canada on "The Design of the Residential Environment" (Section 114). The amendment of the Bank Act to permit the direct participation of the Chartered Banks in NHA lending without regard to the 6% interest limit would encourage a constant flow of private investment funds willing to compete for NHA mortgages. Land developers, as entrepreneurs, would then be permitted a greater freedom of choice than now obtains.

6. It is axiomatic that the ability of a private developer to hold land for long periods of time is a direct function of his capital resources, which obviously can never match those of Federal or Provincial Governments. The use of public funds for land development, as presently being administered by CMHC under Federal-Provincial land assembly projects, represents a subsidy which is not always directed to those in need of it. The Urban Development Institute, in a brief to the Federal Government (see Appendix "B" attached) has already recommended that if public funds invested in Federal-Provincial land assemblies were to be re-directed to help municipalities install trunk services, the proportional benefits to all tax payers would be far greater.

[illegible]:

3. The experience of the Federal Housing Authority in the United States, [illegible]

4. Despite the intention of mortgage lending under the National Housing Act to permit Canadians to borrow funds at low interest rates in order to build or purchase new homes, this purpose is not being served to-day. For example, in Metropolitan Toronto it is impossible for a Canadian with a salary of $5,000. per annum - which is considerably in excess of the average income in Canada - to purchase a new home under NHA Regulations. Similar difficulties are experienced in all urban areas. This situation results, largely, from the increased cost of building lots through demands by municipalities for the installation of pre-paid services by the developer. The latter, in order to recover his costs, [illegible]

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7. In many cases, particularly in Ontario, the inability or unwillingness of municipalities to finance the provision of municipal trunk services in advance of building demands, has created artificial shortages of serviceable land. This, in turn, has resulted in disproportionate increases in the prices of raw and serviced land, and hence of the building lot. It is not surprising that the general public has reacted with shock and amazement on realizing that the cost of a new home is directly affected by the increase in the cost of serviced land. In the past ten years, land costs have risen by more than 200% ! (see Appendix "C" attached). On the other hand, the assurance that trunk services would be available in time to meet the growth requirements of any municipality could do more to curb inflation in the price of raw and serviceable land than any other factor in Government control. In this connection, the recent action by the Federal Government in amending the National Housing Act so as to establish low interest bearing funds for use by municipalities in the construction of trunk sewers and sewage disposal plants, is highly commendable. However, consideration should be given to the extension in the use of such funds for other municipal services.

8. Whilst it is of course conceded that direct government lending through CMHC is both necessary and desirable in those areas of Canada where private or other investment funds are not readily available, or in times of "tight money", there is a need to encourage a greater participation of private investment funds in housing loans. This could be achieved through the development of a strong secondary market for NHA loans. Subject to certain realistic changes and amendments to the regulations governing NHA approved loans, in order to ensure greater liquidity, the trading of NHA mortgages on a basis comparable to the trading in Government and other bonds would stimulate the Canadian capital market and ensure a flow of competitive investment funds for the further development of this country.

9. The strength of Canada lies in the free and independent spirit of its people. It is the ambition of all - or nearly all - Canadians to own their own homes: an investment which may be the most important to the individual Canadian, and to Canada.

All of which is respectfully submitted.

D. G. MacDonald
PRESIDENT

Suite #29, Office Mezzanine,
King Edward Sheraton Hotel,
Toronto 1, Ontario.

APPENDIX "A"

URBAN DEVELOPMENT INSTITUTE

(Ontario Division)

THE URBAN DEVELOPMENT INSTITUTE (ONTARIO DIVISION) IS AN ASSOCIATION OF ACTIVE LAND DEVELOPERS IN THE PROVINCE OF ONTARIO. THE INSTITUTE WAS FORMED IN 1957 IN RECOGNITION OF THE FACT THAT THE PROVIDING OF LAND FOR HOUSING AT A PRICE WITHIN THE MEANS OF THE AVERAGE PERSON, HAS BECOME A SERIOUS SOCIAL PROBLEM. ONE OF THE MAJOR DIFFICULTIES IN THE SOLUTION OF THIS PROBLEM HAS BEEN THE LACK OF A SINGLE RECOGNIZED CHANNEL OF COMMUNICATION BETWEEN LAND DEVELOPERS AND MUNICIPAL AND OTHER LEVELS OF GOVERNMENT SO AS TO PERMIT GREATER UNDERSTANDING AND COOPERATION IN MUTUAL PROBLEMS.

IN ORDER TO BE MORE REPRESENTATIVE OF FIRMS AND COMPANIES ENGAGED IN LAND DEVELOPMENT IN ONTARIO, THE INSTITUTE ACCEPTS AS ASSOCIATE MEMBERS CERTAIN SELECTED FIRMS IN THE FIELDS OF SUBDIVISION ENGINEERING AND TOWN PLANNING. THE INSTITUTE IS THUS ABLE TO SPEAK WITH A SINGLE VOICE IN THE INTEREST OF BETTER UNDERSTANDING WITH THE VARIOUS LEVELS OF GOVERNMENT, TO ENSURE CLOSER COOPERATION IN ALL MATTERS AFFECTING LAND DEVELOPMENT.

STATEMENT OF POLICY

In March of 1960 the Urban Development Institute (Ontario Division) received its Provincial Charter as a non-profit organization, having the following aims and objectives:

(1) TO PROMOTE well planned communities by encouraging the reasonable and economic use of land.

(2) TO PROMOTE efficiency and a high standard of ethics among persons and corporations engaged in land assembly and development.

(3) TO PROMOTE understanding and co-operation between persons and corporations engaged in land assembly and development, and municipal planning, and other government authorities and agencies.

(4) TO PROMOTE the availability of building lots at the lowest possible cost.

(5) TO PROMOTE revisions in the tax structure so that land alone would not be required to produce the revenue necessary for educational and social services.

The Institute maintains a Central Office in Suite 29, Office Mezzanine, King Edward Sheraton Hotel. This Office is organized as a clearing house of information for the membership, and acts as a focal point between the members of the Institute and officials of all levels of government.

Appendix "B"

RESOLUTION No. 3

SUBJECT: Land Assembly (Federal-Provincial)

SUBMITTED BY: A. J. Scott, President, Urban Development Institute.

ADDRESSED TO: Government of Canada (The Honourable the Minister of Public Works)

WHEREAS, development of land through Federal-Provincial Land Assembly Schemes was intended to provide serviced lots for housing at a reduced cost, the purpose of such schemes is frequently frustrated when finished lots are purchased on a first-come, first-served basis,

AND WHEREAS, certain financial considerations such as the purchase of the land by the partnership at a price below the existing market price, the omission of normal carrying charges such as would be met by a commercial land developer, and the absorption by CMHC of architectural and planning costs which a commercial land developer would need to charge against the project, results in the finished lots being sold at what represents a substantial subsidy per serviced lot which, on the basis of sales on a first-come, first-served basis is not directed to the persons normally considered to be in need of such assistance,

AND WHEREAS, the alternative sale of Federal-Provincial land, when ready for building, at public tender or in some other fashion so as to realize a portion of the profit obtainable, would thus result in the acquisition of funds, which, if subsequently channelled into the provision of trunk services in the community concerned, would have the overall effect of reducing the cost of serviced lots,

AND WHEREAS, if a portion of the profit, which could be realized through the sale of Federal-Provincial land assembly parcels at public tender or some comparable means, were thus applied in terms of trunk services in the community in which the assembly has taken place, a continuity in supply of lower cost serviced land would be assured in future.

THEREFORE BE IT RESOLVED:

(a) The sale of Federal-Provincial land by public tender, auction or some other basis calculated to result in a proportion, at least, of the profit involved in these operations being realized, would result in sufficient funds accruing to the Federal Government to finance the proposed installation of trunk services in the municipality in which the Federal-Provincial Land Assembly has taken place.

(b) The above resolution of the Urban Development Institute is endorsed and supported by the National House Builders' Association as an effective means towards the ultimate reduction in the price of serviced lots, thus giving to a larger segment of the population the opportunity to purchase a new home.

MOVED: A. J. Scott, Toronto

SECONDED: W. M. Thompson, Toronto

CARRIED: Executive Meeting of NHBA,
Quebec City, December 8th, 1959.

Appendix "P"

[illegible]

[illegible]: Land Assembly (Federal-Provincial)

[illegible] BY: A. J. Scott, President, Urban Development Institute.

ADDRESSED TO: Government of Canada (The Honourable the Minister of [illegible])

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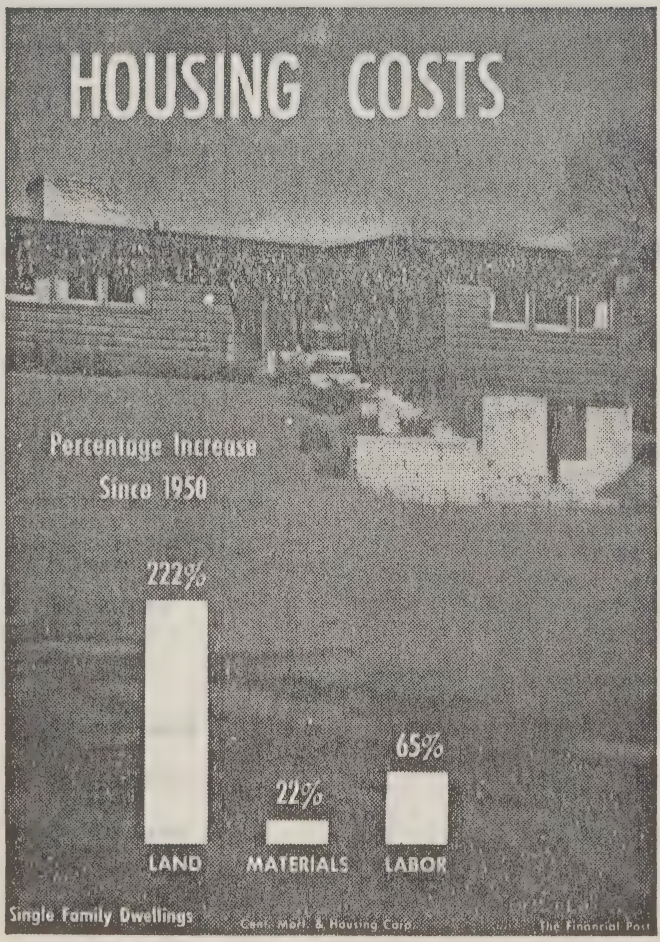
MOVED: A. J. Scott, Toronto

SECONDED: W. M. Thompson, Toronto

CARRIED: Executive Meeting of NHBA, [illegible]

APPENDIX "C"


HOUSING COSTS
Percentage Increase
Since 1950
222%
22%
65%
LAND
MATERIALS
LABOR
Single Family Dwellings
Cent. Mort. & Housing Corp.
The Financial Post

BRIEF TO THE

ROYAL COMMISSION ON BANKING AND FINANCE

THE SECURITY ANALYSTS' ASSOCIATION OF TORONTO

OFFICERS

Paul S. Deacon	President
Leonard E. Barlow	Vice-President
Philip W. Speller	Secretary
J. B. Purdy	Treasurer

DIRECTORS

J. W. Aylward	E. E. Hickson
L. E. Barlow	J. B. Purdy
P. S. Deacon	P. W. Speller

C. W. Goldring

April 4, 1962

TABLE OF CONTENTS

1. The Security Analysts' Association of Toronto is one of 28 member societies of the Financial Analysts Federation. Two of these are in Canada and the rest in the United States. Among the Federation's main functions is one described in the constitution as follows: "To work toward improvement in the quality and quantity of financial information disseminated by corporations; to make and publish surveys and studies with recommendations for improvement of corporate financial reporting."

2. Analysts are interested in promoting better information for several reasons. Two of the most important are:

1. Adequate information is essential to assess companies and industries and hence their securities. If investors are forced to apparise values on the basis of inadequate information, they are more likely to make bad decisions and to lose confidence in investing.

2. Good information, widely disseminated, promotes broader interest in a security. As more investors become interested in a stock or bond, it becomes much easier to buy or sell that security, and both buyer and seller can have more confidence that the price is fair. Development of broader and more dependable markets for securities makes it easier to finance projects in Canada and to promote still wider ownership of existing companies.

3. Our Association considers the existence of adequate corporate information to be of concern to this Commission

because broader ownship of securities by Canadian individuals and institutions is vital to the development of Canada's business and industrial life on a sound basis.

4. The provisions of the federal and provincial Companies Acts which set the minimum standards for much of the information now available on Canadian companies, were written, in the main, to protect minority owners from the abuses that might result from the actions of the controlling shareholders.

5. Our purpose is much broader. We do not quarrel with the right of the majority to rule. We suggest, however, that management and the controlling shareholders consider minority shareholders as partners and provide them with information that will allow them to be intelligently informed about their company's affairs. Because this information is made public to shareholders, it should also be made available to all investors so that a more accurate appraisal of the company's securities can be made.

6. We commend the Investment Dealers' Association of Canada and the stock exchanges for their endeavours to secure better standards of information.

7. Many companies, through enlightened self-interest, are voluntarily going far beyond the legal minimums, by providing better and more frequent information on their affairs. However, we believe that some compulsion may be

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needed to bring other companies up to adequate standards.

8. We propose to discuss the present state of information on publicly-owned companies under the following headings:

1. Annual Reports.
2. Interim reports.
3. Proxy information.
4. Prospectus information.
5. Jurisdictional problems.

9. In this brief, we cannot go into detail of all the aspects of the problem. However, here are some of the recommendations to which we wish to draw special attention:

1. Annual Reports:

(a) All companies should provide sales figures because this is a key figure in measuring management efficiency. Of 300 Annual Reports covered by a survey of 1960 reports of manufacturing, merchandising and distributing firms, only 30% supplied sales figures. Because this survey dealt with the leading firms in the main, the proportion for all Canadian companies is, undoubtedly, much lower.

(b) All company reports should provide comparative figures in the accounts, to provide a proper perspective in assessing company results. The standard here has greatly improved, but still leaves much to be desired. The survey of 300 reports showed that 59% gave all statements in a comparative form, 11% presented some statements in comparative form and

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1. [illegible]

2. [illegible]

3. [illegible]

4. [illegible]

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30% showed no comparisons at all.

(c) All companies which have committed themselves to long-term lease payments should give information about these future liabilities in their financial statements or the accompanying notes. We recognize that accountants do not agree on the best method of presentation, but in at least one case, involving millions of dollars of these future payments, no mention is made of the liability in the financial statements. In the 300-report sample, it was deduced that at least 68 firms were committed to long-term leases, yet 46 provided no details at all. Because this has become such a common method of acquiring the use of capital assets and, in some businesses, such a key source of funds, disclosure of the details of lease commitments should be mandatory.

(d) Accounts of all subsidiaries should be consolidated, the subsidiaries identified and the basis of consolidation set out. Some provinces already provide for this, but the federal and some provincial Companies Acts do not. Of 221 firms with subsidiaries, 74% consolidated all subsidiaries, 13% included some subsidiaries and excluded others and 13% left subsidiaries out of the statement. Relatively few provided information as to the basis of inclusion or exclusion of the accounts of subsidiaries. About 70% disclose the name of some subsidiaries and 56% name all subsidiaries.

2. Interim reports:

Shareholders in Canada should receive financial information on their companies more than once a year.

To illustrate the general backwardness of financial reporting in Canada, the Toronto Stock Exchange mailed a letter to its listed companies in 1959 urging them to provide interim (preferably quarterly) financial reports. The letter used was, in essence, the letter used for the same purpose by the New York Stock Exchange 33 years before, in 1926.

This attempt has had results that still leave much to be desired. Of the 300 companies included in the survey of Annual Reports, only 58 produce interim financial statements.

3. Proxy information:

When a shareholder in Canada receives notification of a shareholders' meeting, about the only information he receives with it, aside from a brief agenda, is a request for a proxy signed in favour of management.

No provision is made in the form to allow him to direct how his shares may be voted at the meeting. There is also no space to appoint any other persons to vote his proxy.

We recommend:

(a) That the proxy material should contain much more information and, in simple terms, details on the measures to be discussed at the meeting so that the shareholder can vote his proxy intelligently. In particular, it should include more

information on the qualifications and financial interests of the persons standing for election as directors.

(b) That the proxy form should give him the opportunity of instructing management how to vote his shares on individual measures being put before the meeting.

(c) That all proxy material be presented in an unbiased way, so that it will be fair disclosure, not a selling document to promote management's viewpoint.

4. Prospectus information:

On the whole, the disclosure of information in prospectuses for new issues is satisfactory.

Some improvements are recommended, however. These include more information on the salaries of executives and material contracts affecting the business, disclosure of beneficial owners of 10% or more of the voting stock and how much they own, details of executive stock options, bonuses and pension plans.

5. Jurisdictional problems:

We envisage that the long run solution to the disclosure problems will be the voluntary acceptance of full disclosure standards by all companies whose securities are owned by the public. In view of the reluctance of some companies to comply voluntarily, some compulsion may be necessary.

10. There are three main types of organization through which information standards might be improved:

(a) the Investment Dealers' Association of Canada, which includes all the country's leading underwriting firms;

(b) the stock exchanges, and

(c) the federal and provincial governments, all of which through Companies Acts (and in the case of the provinces, through Securities Acts) set information standards.

If the Investment Dealers' Association and the stock exchanges are not in a position to speed up the acceptance of better disclosure standards by laggard companies, the responsibility must fall on government.

11. The form which government legislation would take is obviously beyond our field as analysts. However, having an earnest desire to see some action result, we wish to suggest some approaches that this commission might examine:

1. Legislation governing companies and securities should contain requirements for high and uniform standards of disclosure. Failure to comply with these standards should be made an offense.

2. Any solution to the problem should not involve bureaucratic review of all material of all companies.

3. An aggrieved shareholder should be in a position to require investigation by government officials leading to a decision to prosecute or not.

4. In the event that no action is taken by the government, an inexpensive and expeditious method of laying a complaint should be supplied through a board or commission similar to the Tax Appeal Board.

5. Breach of the statutory provisions should not just involve a small penalty. The law should provide for restraint of continuing breaches.

Memorandum on Annual Reports:

1. Annual Reports are one of the chief sources of material available to most shareholders and investors for use in assessing a company. Interim financial reports, annual meetings, prospectuses issued in connection with offerings of new securities and releases to the press on company developments all help to add to the sum of knowledge about a company's affairs. However, the Annual Report is, or should be, a basic and well documented picture of a company's affairs.

2. We are appending to this section a summary of reports of the Corporate Information Committee of the Financial Analysts Federation on standards for Annual Reports. This gives the detail that experienced analysts feel should be contained in a report.

3. We might point out that while the material listed looks almost self-evident, some reports do not even state what business the company is in, let alone provide the financial and other detail necessary for appraising the company and its securities. Investors should be able, through the Annual Report, to relate the company's performance to that of the industry as a whole. They should be given some idea of the effect of any government investigations or reports that have a bearing on the business. Full disclosure means providing all the facts relevant to the business.

4. Sales information, for instance, is frequently withheld by companies on the grounds that this information can be used against them by their competitors. Competitors may be attracted to a market, some companies say, if they can discover from published sales figures what the size of the market is, or what a particular company's share of the market is. Yet it is possible to argue just as forcefully that new competition might just as easily be attracted to a market because sales figures are not published and because competitors over-estimate the business available.

5. In most cases, probably, disclosing sales would not really be a big factor in determining the effectiveness of competition, because companies generally know fairly closely just how much business others in the industry are doing. Hiding sales figures, we suspect, is more a habit than a thoughtful and well-reasoned decision by management. In the United States, of 600 companies used in a survey*, 98% disclosed sales or net sales in the income statement and U.S. industry manages to survive.

6. Because only 30% of companies supply sales figures in Canada, according to a survey of 300 companies**, an analyst of Canadian securities usually has to work without this

* "Accounting Trends and Techniques", 1960 edition, published by the American Institute of Public Accountants.

** "Financial Reporting in Canada", 1961 edition, published by the Canadian Institute of Chartered Accountants.

particularly useful tool for measuring a company's performance. He is unable to make such basic checks of performance as relating the trend in profit to the trend in sales, or the trend in a company's sales to over-all industry sales, or the trend in sales to the growth of the country.

7. We believe that by providing the facts called for in the Financial Analysts Federation recommendations on Annual Reports, companies will do a service not only to analysts and the community, but also to themselves. Management, in this era, must make plain the company's contribution to the economic life of the country by showing that it is building a solid enterprise, and by providing an adequate record of the company's progress. In so doing, an efficient company will also simplify its money-raising problems.

8. Reporting of Financial Institutions

1. It appears particularly appropriate before this Commission to refer briefly to the reports of financial institutions.

2. The Association notes with approval the generally satisfactory Annual Reports of companies engaged in the instalment finance business. Indeed, the reports of Industrial Acceptance Corporation have, for a number of years, provided a high standard of readibility and disclosure comparing favourably with companies in any other industry.

particularly useful tool for measuring a company's performance. He is unable to make such basic checks of performance as relating the trend in profit to the trend in sales, or the trend in a company's sales to over-all industry sales, or the trend in sales to the growth of the country.

[illegible] in the Financial Analysts Federation recommendations on Annual Reports, companies will do a service not only to analysts and the community, but also to themselves. Management, in this [illegible] life of the country by showing that it is building a solid enterprise, and by providing an adequate record of the company's progress. In so doing, an efficient company will also simplify its money-raising problems.

6. <u>Reporting of Financial Institutions</u>

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3. Unfortunately, such standards of corporate reporting are not met by other areas of banking and finance. Reporting by chartered banks, trust companies, loan companies and investment companies leaves much to be desired. Shares of chartered banks are widely held by investors and their operations have wide-spread implications on the entire economy. A comment upon inadequacies of chartered bank reporting would appear well justified by this Association since given the existing level of this reporting, the qualified security analyst finds it impossible to do his job competently.

4. We will not attempt to describe in detail the information which should be provided, but would mention a number of general areas of information, most of which are provided by United States commercial banks, which we consider necessary to an intelligent appraisal of chartered bank equities:

(a) Operating revenues showing major revenue sources.
(b) Operating expenses.
(c) Operating profits <u>before</u> transfers to internal reserves.
(d) Comparative data for previous year.
(e) Size of internal reserves.
(f) Interim reports (quarterly preferred).

5. Generally speaking, there is little to be desired with the detail concerning balance sheet data, but information provided in the income account (statement of undivided profits)

as prescribed under the Bank Act is inadequate by today's accepted yardsticks of good corporate reporting. While there were undoubtedly valid reasons for originally providing for chartered bank reporting on its existing basis, there can be little argument that times have changed, ownership of corporations has become widely distributed and that a better understanding of banking operations would further the confidence of the public in our financial institutions.

Memorandum on Interim Reports:

1. There is no requirement under Canadian law or under the by-laws of any Canadian Stock Exchange or Investment Dealer Organization that requires publication of interim financial reports.

2. The Toronto Stock Exchange and the Montreal Stock Exchange in 1959 both circulated a request to listed companies to provide interim reports, preferably each quarter. There was some indication of interest, but most firms not providing these reports either refused outright or ignored the request altogether.

3. By contrast, all but 1% of the companies whose shares are listed on the New York Stock Exchange publish interim financial statements, and all but 6% publish these quarterly. The only firms which are exempt are companies whose operations depend on one crop a year (e.g. sugar, tobacco growers) and a non-operating steel and iron company which had leased its properties.

4. In Canada, of 300 manufacturing, merchandising and distributing firms whose Annual Reports were used in a recent study of financial reporting in Canada*, only 58 provide interim financial reports. Of these, only 31 publish them quarterly.

5. This means that shareholders of most Canadian companies must wait at least a year (and sometimes longer) for

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a financial report on their firm's activities. Because the annual results are frequently released three or four months after the year end, much of this material is outdated, particularly, if it refers to events in the early part of the previous fiscal year.

6. We consider that this lack of interim information is damaging to the interests of the shareholders and investors generally and, in the long run, to the interests of the company.

7. Some companies fear that interim information will somehow damage their competitive position. We can only point to the remarkably successful firms whose names are prominent among the firms which do report quarterly.

8. Some firms say that shareholders will get a distorted picture from quarterly reports, because one season is busier than another. Comparative figures for the previous year or (as one company shows) for the previous five years, reduce the effect of seasonal fluctuations in the comparison. Another method is to show the previous 12-month total (e.g. the first quarter of 1962 and the last three quarters of 1961).

9. A requirement for interim reports is probably enforced best through the stock exchanges, as a condition of listing. So far, however, the exchanges have not brought themselves to the point of making such a rule. The Investment Dealers' Association of Canada might require that companies

whose issues are being underwritten by its members, give an undertaking to provide interim reports. If neither of these methods is workable, interim financial reports might be made part of the required information under the Companies Acts.

10. Content of the interim reports need not be elaborate. The main items to be covered should include sales and other revenue, cost of goods sold, depreciation and depletion and other write-offs, income and other taxes, and net profit. Some balance sheet items would be helpful, particularly working capital. The statements need not be audited. There should be comparisons with the comparable period of the previous year and the cumulative results for the fiscal year up to the end of the period covered. If there are unusual changes up or down, management should provide a brief explanation.

Standards for Annual Reports

Summary of Reports of the Corporate Information Committee Financial Analysts Federation 1955-6, 1957-8, 1960-1.

A. ESSENTIAL INFORMATION:

1. Detailed Comparative Income Statements - Two Years

Sales; cost of goods sold; selling, general and administrative expenses; depreciation, depletion and amortization; other income; interest charges; income taxes and minority interest.

2. Detailed Comparative Balance Sheets - Two Years

Cash; marketable securities; receivables; inventories (including breakdown by stage of processing); investments; gross and net plant; accounts payable; taxes; loans; reserves (detailed); capital surplus; earned surplus; capital; dividend restrictions and sinking fund requirements.

3. Operating review of year

Discussion of sales trends, profit margins and financial position; new research developments; competitive position; foreign operations; basic policies and objectives of management; capital expenditures (detailed) and cash requirements; outlook and physical production.

4. Explanation of Accounting and Consolidation Methods

Inventory valuation method; depreciation and amortization method; foreign subsidiaries and extraordinary items.

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1. Detailed Comparative Income Statements - Two Years

Sales; cost of goods sold; selling, general and administrative expenses; depreciation, depletion and amortization; [illegible] payment.

2. [illegible]

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4. Explanation of Accounting and Consolidation Methods

Inventory valuation method; depreciation and amortization method; foreign subsidiaries and extraordinary items.

5. Surplus Reconciliation

Income; extraordinary debits and credits; transfer of capital; appropriated surplus and dividends.

B. DESIRABLE INFORMATION:

1. Statistical Summary of Operations - Current vs. Previous year (essential in 1960-61)

Sales; pre-tax net; taxes; net income; per share earnings and dividends; shareholders' equity; working capital; capital expenditures and depreciation.

2. Source and Application of Funds

3. Sales Breakdown

By divisions or by industries served - foreign and domestic.

4. Ten-Year Comparative Statement of Income and Balance Sheet Items

5. Research and Development Expenditures

6. Labour Relations, Policies and Costs

C. USEFUL INFORMATION:

1. List of Officers and Directors with Affiliations

2. Description of New Products

3. Industry Trends

Demand, supply and prices; domestic and foreign competition; tarrifs and exchange rates.

4. Description of Outstanding Securities, Options and Pension Arrangements

D. ADDITIONAL INFORMATION:

1. Lease Arrangements
2. Table of Contents
3. Description of Plants and Properties
4. Summary of Products Made

Memorandum on Proxy information:

1. At the present time, regulation governing the form of the proxy instrument and information to be provided shareholders during proxy solicitation is that contained in the Corporations Acts of the provinces and the federal Companies Act (as amended). The provincial Securities Commissions have accepted these requirements for companies issuing securities under their jurisdictions, as have the stock exchanges in connection with companies whose shares have been accepted for listing.

The present proxy form generally in use in Canada is no more than the opportunity to give a vote of confidence to management. There is no provision, through space or explanatory note, for the appointment of an alternative proxy. There is no provision for the shareholder to oppose the appointment of directors. There is no provision for the shareholders to specify approval or disapproval of individual matters coming before the Board which require shareholder authorization. There is generally little, if any, description of these matters in any event. The whole procedure prevents any rational exercise of his franchise by a shareholder - in effect he either supports present management or loses his vote.

2. Since it is clearly evident that the existing legal requirements are insufficient to permit the intelligent exercise of a shareholder's vote, a matter of vital concern in our free enterprise economy, expansion of existing requirements pertaining to this matter is considered essential.

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3. (iii) In the United States proxy statements must provide a considerable amount of information to the shareholder, some of which we deem to be relevant and very desirable for incorporation as required proxy procedure in appropriate Canadian statutes.

In brief, proxies requested from shareholders for an annual or a special meeting should be accompanied by a statement from the company giving:

(a) Method of proxy solicitation - disclosing use of paid proxy solicitors, cost of solicitation and by whom it is to be borne.

(b) Description of any beneficial interest of any director or officer or his nominee in any matter to be acted upon at the meeting.

(c) Pertinent details of voting securities and the record date of security holders entitled to vote.

(d) Disclosure of the names of all parties beneficially owning 10% or more of the company's voting stock.

(e) Information on the proposed directors whose election is to be supported by the management-designated proxy-holders as follows:

(i) principal occupation, corporate affiliations and employment during the past 5 years;

(ii) individual beneficial interest in all equity securities;

(iii) details of any arrangement with other persons concerning the election; and

(iv) remuneration of any receiving, or expected to receive, $25,000 in the year in any capacity, including details of all indirect remuneration including bonus, profit-sharing, stock options and pension benefits.

(f) Details of any indebtedness of any director or officer to the company.

(g) Details of any material transactions involving any director, officer or director-nominee to which the company was a party.

(h) Full, true and plain disclosure of details concerning any matter on which authorizing action is to be taken by the shareholders at the meeting.

4. The form of proxy itself should provide:

(a) a blank space in which the shareholder may, if desired, appoint as his proxy someone other than those designated by the management;

(b) suitable space for the shareholder to designate his vote for or against the proposed slate of directors, and

(c) suitable space for the shareholder to designate his vote for or against each proposal to be put before the meeting for shareholder authorization. These proposals to be identified for reference to the proxy statement where they are fully described.

Memorandum on Prospectus Information:

1. In a recent questionnaire to security analysts, it was found that the prospectus was second only to statistical services as the major source of financial information employed.*

Not only does the prospectus provide information vital to a proper evaluation of the new security issue which it describes but often it provides information on the issuing company which is not otherwise available to the investing public.

In view of the importance of prospectuses in providing information, particularly on new stock issues, a study of the adequacy of present regulations governing the content of prospectuses issued in Canada has been made by the Association.

2. Regulation of new security issues and, therefore, of prospectus requirements comes primarily under the various provincial Securities Acts. Most new issues are distributed at least in part in the Provinces of Ontario and Quebec and conformity with the Acts in these provinces is effectively the requirement for the majority of new security offerings. By the nature of their work, the Association's membership is not concerned with the speculative "junior" mining or oil

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3. The Securities Acts provide that primary distribution of industrial securities can only be made after filing with the Commission or other regulatory body, a prospectus which sets forth certain specific information. For example, the Ontario Act (Part VIII Sec. 39 (1)) lists 35 specific items of information which must be provided. This information is normally included in the last section of a prospectus under the heading "Statutory Information".

4. The Securities Acts* also require that prospectuses shall include financial statements consisting of a balance sheet as at a date within 120 days of the prospectus' date and an earnings statement covering the last five completed financial years.

5. In addition to the required information, prospectuses contain, as an introduction provided by the company to the underwriters, certain material descriptive of its history, operations and outlook. Provision of this information is entirely discretionary, but in recent years, efforts by the underwriters have substantially improved and expanded the content of this material. It may be said that in the case of most substantial established industrials, prospectus information is satisfactory at present. Indeed, Canadian prospectuses seem to provide a more readable document than those issued

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under U.S. regulations and hence enable the individual investor to obtain a better understanding of the security offered. In the case of junior industrials, particularly the initial public offering of equity in smaller, little-known companies, however, it is felt that the supplementary information is often sparse.

6. Uniformity of prospectus requirements in the different provinces is, of course, very desirable and it is encouraging to note that progress has been made toward establishing uniformity in the various provincial Securities Statutes.

7. While it appears that the requirements of the present Acts produce most of the vital information necessary to judge a new issue, except for some additional points to be covered later in this memorandum, the form in which financial information is disclosed reflects the weaknesses in financial reporting (see Memorandum). While the Securities Acts provide that the financial statements required in a prospectus "be drawn up in such manner and contain such information as the Commission may from time to time require" the Association feels that improvement in the quality of financial statements should be obtained through improved Annual Reports rather than by requirements of prospectuses. More adequate disclosure in Annual Reports would undoubtedly be reflected in the form in which financial statements are presented in prospectuses.

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8. The areas in which it is felt that present prospectus requirements are insufficient are:

(a) Management remuneration - Present requirements showing the total of remuneration to officers who individually receive over $10,000 per annum seems out of date considering that most larger companies would have a number of junior officers above that level. The requirement does not provide any disclosure of the excessive payment to a chief executive which might weaken a small company in that it does not disclose how many executivies participated in the aggregate remuneration disclosed. The quality of management may often be judged by the spread in remuneration between the top and second-line management.

In addition, remuneration of management is increasingly by indirect means, such as stock purchase options, bonus or profit sharing plans and retirement benefits. These can be as important, or more so, than direct remuneration.

We propose that disclosure of remuneration provide the total paid to the three highest-paid executives, the total paid to all officers receiving above $10,000 (as presently required), the number included in this group and details of all stock options granted to management along with the total of bonuses and of pension provisions for the three highest paid executives.

(b) Beneficial ownership - Present requirements cover disclosure of ownership, in stock issues, of those in a position

to elect a majority of directors. This does not cover the many instances where effective control of a company is held through ownership, directly or by nominees, of something less than 50% of the voting stock. We suggest that disclosure be made of the names of all parties beneficially owning 10% or more of a company's voting stock.

(c) Material contracts - Present requirements cover disclosure of "the dates, parties to and general nature of every material contract entered into within the two preceding years" but not applying to contracts "entered into in the ordinary course of business". In addition, particulars of property purchased or acquired payable to some extent in securities or from the proceeds of an issue, must be given unless again this occurs in the ordinary course of operations. These requirements appear to offer loopholes to companies who carry on some real estate operations as transactions of a major and very material nature can be ignored as being in the course of business. The use of the term "general nature" has the effect of not requiring details of the contracts and hence the information necessary to judge the effect of such contracts is not provided.

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9. While the regulations covering prospectuses and the disclosure of information therein appear generally satisfactory, they do throw a heavy burden on the staffs of the various provincial authorities who administer the Securities Acts. The increasing complexity of business and the growing volume of corporate issues has taxed the capacity of the relatively small staffs available for vetting prospectuses in most jurisdictions. Larger qualified staffs would permit closer scrutiny of the Statutory Information provided and would lead to disclosure of more complete information,particularly in the case of "junior industrials".

10. To help relieve the Provincial Securities Commissions' staffs of unnecessary work and permit them to concentrate on areas where the protection of the public is more likely, it is suggested that the definition of "institutions" for private placement exemption of prospectus filing be broadened to increase the number permitted in such a placement and to include institutions not presently considered exempt, such as pension funds, investment trusts and special funds such as the Canada Council. These buyers are well-qualified to obtain all information necessary to a reasoned judgement of a security without the protection provided by the prospectus" provisions. These provisions often become financially burdensome to the financing of small companies. It is recommended that exemption from prospectus filing be extended to placements of up to 25

individual sales to an expanded list of qualifying institutions without limitations as to the number to which an offering may be made.

11. Further reduction in securities staffs' work would become possible if sufficient uniformity in the various Provincial Acts were reached so that vetting by one of the major Commissions was automatically sufficient for approval by all other Provinces. This procedure would also reduce the cost to prospective issuing bodies.

Memorandum on jurisdictional problems:

Two paragraphs from "Securities Regulation in Canada"
by J. Peter Williamson

Twenty-five statutes have a direct effect on the sale of securities in Canada. Each of the ten provinces has a securities act or security frauds prevention act, regulating the sale of securities in the province; (83) Alberta, Ontario and Saskatchewan have investment contract acts, regulating the issue of investment contracts in these provinces; (84) the Ontario Corporations Information Act and the Quebec Companies Information Act are very similar to securities acts and impose prospectus requirements on the sale of securities in Ontario and Quebec respectively; (85) and the companies acts of the Dominion and all the provinces except Ontario and Quebec and the Yukon Companies Ordinance, regulate the sale of securities by companies incorporated or licensed under them. (86).

Note 1

Securities regulation in Canada is a complex affair. The complementary and often overlapping provisions of companies and securities acts require careful search and detailed analysis, before anyone can be sure of a registration requirement or a possible source of liability. The lack of uniformity in both the companies and the securities acts is more than simply lack of identical requirements; it is a hodge-podge of miscellaneous provisions adopted more or less at random from the statutes of

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other jurisdictions, rarely amended, and scattered through the statute books more as an obstacle course to the legal profession than an effective protection for investors. (122)

The situation in the United States is a little worse because of the larger number of jurisdictions, and a little better, because of the dominant role of the federal government, and the progress made towards uniformity.

Note 2

Note 1 Page 38

Footnotes: 83 - Alberta, 1955, c.64; R.S.B.C. 1948, c.298; R.S.M. 1954, c.237 R.S.N.B. 1952, c. 205; R.S. Nfld. 1952, c.139; R.S.N.S. 1954, c.261; R.S.O. 1950, c.351; R.S.P.E.I. 1951, c.146; Quebec, 1955, c.11; Saskatchewan, 1954, c.89 (in each case, subsequent amendments should be consulted). No securities acts are in effect in the Northwest Territories or the Yukon.

84 - Notes 60-2 above. The Alberta Act is administered by the Securities Commission; the other two by the superintendents of insurance of the two provinces.

85 - Ontario, 1954, c.21; R.S.Q. 1941, c.281.

86 - R.S.C. 1952, c.53; R.S.A. 1955, c.53; R.S.B.C. 1948, c.58 R.S.M. 1954, c.43; R.S.N.B. 1952, c.33; R.S. Nfld. 1952, c.168; R.S.N.S. 1954, c. 41; R.S.P.E.I. 1951, c.26; R.S.S. 1953, c.124; Yukon, 1914, c.18. (in each case, subsequent amendments should be consulted).

Note 2 Page 44

Footnote: 122 - The subject was taken up in the Report of the Royal Commission on Dominion-Provincial Relations, Book 11: Recommendations (1940) at pp.56-7. The Commission contented itself with a recommendation that the companies acts be made uniform and the duplication of reporting be eliminated.

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Hearings held at

TORONTO

Vol. 13

Date. April 16, 1962

Official Reporters
F.J. Nethercut and R.J. Young
Toronto, Ont.

Toronto, Ontario,
April 16, 1962.

ROYAL COMMISSION ON
BANKING AND FINANCE

INDEX

ROYAL COMMISSION ON BANKING AND FINANCE

Hearings held at Toronto, Ontario, on Monday, April 16th, 1962.

THE COMMISSION

The Honourable Dana Harris Porter
Chief Justice of Ontario
Toronto, Ontario - Chairman

Mr. W. Thomas Brown, M.B.E.
Investment Dealer
Vancouver, British Columbia

Mr. James Douglas Gibson, O.B.E.
Banker
Toronto, Ontario

Mr. Gordon L. Harrold
Agriculturalist
Calgary, Alberta

Mr. Paul H. Leman
Corporation Executive
Montreal, Quebec

Mr. John C. MacKeen
Corporation Executive
Halifax, Nova Scotia

Dr. W.A. Mackintosh
Vice-Chancellor
Queen's University
Kingston, Ontario

Mr. H.A. Hampson - Secretary

Mr. Gilles Mercure - Joint Secretary

Toronto, Ontario,
16th of April, 1962.

THE CHAIRMAN: I shall call the meeting to order. Mr. Allan.

HON. J. N. ALLAN: Chief Justice Porter and gentlemen, I am here this morning on behalf of the Prime Minister of the Province to indicate to you, the members of this Commission, how delighted we are that you are sitting in Ontario. We want to especially welcome those who are not residents of Ontario to our province.

We want to wish your Commission every possible success and particularly we want to thank you for your consideration in arranging to accept the brief that will be presented by the province later this summer. It is not ready now and we are most grateful to you for your consideration in that respect.

THE CHAIRMAN: Thank you very much, Mr. Allan. We appreciate very much indeed your very kind words of welcome and we shall look forward to the Ontario brief at a later date.

The nextbrief is that of Geoffrey R. Conway and Martin W. Goodman. Mr. Conway?

MR. CONWAY: Sir.

SUBMISSION OF GEOFFREY R. CONWAY
AND MARTIN W. GOODMAN

APPEARANCES:

Geoffrey R. Conway
Martin W. Goodman.

MR. GOODMAN: Gentlemen, my name is Martin Goodman. May I read the summary now?

THE CHAIRMAN: Yes.

MR. GOODMAN: There is a slight addition which the Secretary had kindly allowed us to include.

--- Reads summary of brief.

THE CHAIRMAN: Questions?

COMMISSIONER BROWN: Mr. Chairman, I wonder if I might open this discussion by asking a general question which Mr. Goodman may wish to discuss.

In your brief you use almost entirely fiscal policy as a means of helping the economy and there is virtually no mention of the efficacy of monetary policy. I think the Commission would be pleased if you would discuss why you did this and also your ideas on whether monetary policies have any effect.

MR. GOODMAN: Our main constraint about discussing monetary policy was lack of time. That is why we took pains to add that this is not all we would prescribe. We feel that monetary policy is equally valuable and should be equally emphasized but because of the recent controversies of this nature we felt it would probably get a thorough

airing before this Commission without our particular attention to it. Since we had a lack of time to go into it in detail we felt it best to leave it out of the brief.

You are discussing monetary policy totally and not just as it affects the flow of funds or monetary policy for growth, inflation measures, etcetera?

COMMISSIONER BROWN: Yes.

MR. GOODMAN: I think that this is an area that should be stressed as much as possible. On the other hand, I do not believe that it could be effective by itself. We are concerned that fiscal policy has been overlooked, for instance, there is no reason why taxation rate reductions and increases would not be an adequate government policy to deal with recessions and inflation. At the same time, the difficulty with monetary policy according to the information that we added is that if we reach a balance of payment crisis which we expect, monetary policy forces or monetary policy will be required to deal with this. Now, if you accept the theory that for every goal the government wants to accomplish it has to have a tool, we need monetary policy as a tool to take care of the balance of payments. This leaves only other tools to deal with growth in the domestic economy.

COMMISSIONER BROWN: Would monetary policy be the only tool in the balance of payments problem?

MR. GOODMAN: Not at all, we have some very specific problems that we left out.

COMMISSIONER BROWN: Why do you mention that?

MR. GOODMAN: There are many aspects of both booms -- there were many goals to deal with balance of payments. Exports would be one goal. By the same token a flow of funds would be another goal and a flow of funds is one that monetary policy would be particularly concerned with.

MR. CONWAY: Also at the present time we have had an expansion of the money flow along these lines. There have been moves by the government to say it is not a fact at the present time there is a shortage of funds for expansion of the economy. There is probably a lack of direct stimulus to make use of these funds. We have therefore thought that part of the problem is important to the matter of balance of payments because in the government borrowings the problem facing both federal and local governments is that at the time that they look into the problem of the balance of payments the only way not to have an international crisis in their balance of payments is probably for the federal government to go south of the border and borrow funds there to finance the federal deficit instead of staying in the short term market in Canada. We prefer to see the federal government staying out of the long term market at the present time and leaving this to the provinces

and municipalities. We feel the problem of going south of the border is the exchange rate and other problems in making an issue below the border. There are basic reasons in the monetary policy why the federal government should leave its long term as it is at the present time and if there were not this pressure to go south of the border to obtain long term funds but to obtain short term funds in Canada it could be in the long term an advantage.

We have not gone any further into this problem because of the fact that we felt that steps have been taken and that can be taken are set out fairly detailedly in the other areas and there is no point in going any further.

COMMISSIONER BROWN: Do you think that monetary policy can stimulate the fund?

MR. CONWAY: If used in balance with other factors, yes. If we did not have the flow of funds in the economy or did not have the money supply, did not have the other problems monetary policy could finance the deficit and there would be no difficulty. So this quite definitely would be a necessary part. On the other hand, we stress it again that possibly the government should have done more as a specific policy to get a balanced programme.

COMMISSIONER GIBSON: Mr. Chairman, still on the very general question, I guess most people admire people who come out and make specific

proposals. On the other hand, this is a very complicated sort of country with a lot of differences of view and it is not easy to do specific things. I would very much like to know the sort of background behind your proposals. You come out with a lot of proposals but you do not give us the picture of your philosophy and what you are trying to do. You say there is something wrong with the Canadian economy and it is drifting in such an unsatisfatory way. Everybody knows it is in an unsatisfactory state. This is not an analysis that tells you what to do about it. Would you say a little about your background thinking on this?

MR. GOODMAN: There is, I thought, a bit too much philosophy in the introduction. It is true, we did not speak in some of the areas of the economy like balance of payments but one we warned of here because of what we feared is the imminent danger from the United States from what looks like a current balance but in reality is a probable trade deficit.

Then, the unemployment situation, if you take the goal of stable prices as being very important and you draw a curve you will see at what stage you will say at what stage are we going to have stable prices but it seems to have been the Canadian experience in the last two or three years, certainly since the last two recessions that stable prices keep coming out without too high an

employment percentage.

The growth rate, which in itself, can be questioned - you can say "Why growth?" - well, in growth, it is first that this will be a way to tell the people in the country that some things will operate to correct this growth rate, not simply per capita but in current dollar payments, some sort of stimulus is going to be required. We feel that again the turn-off of investment in Canada is one that would jeopardize your growth. We can develop growth by fiscal and monetary policy. Here we do not say the country is toppling over now but it is at a plateau and our advice is something is needed to make the country move upwards again. This is the general philosophy behind what we are saying on this subject.

COMMISSIONER GIBSON: Let me be a little more specific. I think we are all aware of the very broad complex you speak of but you put emphasis on your programme of increasing the level of investment at this particular time. This is the time when there is a good deal of over-capacity in federal unemployment and other economists perhaps put more emphasis on trying to increase consumption. It is this kind of question I am hoping you will elaborate a little on as to why you are all for investment but not much for consumption.

MR. GOODMAN: The difficulty we found

here was the type of capital structure that we have. The concern we have is that we have a capital structure that is weak when it comes to international winds. We seem to get the first subsidiaries - American subsidiaries here are turned off when a recession comes and when the boom comes they are the last ones to get orders as compared to the American parent companies.

What we feel we need is essentially a more self-sufficient economy in the capital structure. It is true we did not emphasize demand in here. This is the other aspect if we were dealing with the economy as a whole that we would certainly emphasize.

Now, how do we get this better capital structure. Either you can increase demand or increase investment. As we point out, this is a political argument. The difficulty you get into is if you do not want to do it strictly with deficits, therefore which one do you choose. In this case I simply have chosen the investment which will provide sufficient impetus to the capital structure. The Canadian goods aspect is another matter. We are not proposing a general demand capital structure. You will possibly have more of that later on. The demand is something we would have liked to have really known because we were particularly concerned that the seemingly large developments of the recent years do not seem to have brought this about.

COMMISSIONER GIBSON: One of our underlying difficulties in these submissions is to try and prove what the submission states. Are you satisfied with the statements you made earlier there that you have subsidiaries cut off here first and when they start up they start up last, so to speak. These may not be your exact words but have you any evidence to support this view because this is a very important matter?

MR. CONWAY: This is the type of thing that you have brushes with in your knowledge of the Canadian economy as such and you are assuming that people concerned with it can argue about circumstances here in Canada but you can only make certain assumptions.

However, you do know that if the head office of a company has operations throughout the world or in one segment of the world their job to the shareholders is to maximize profit. You have to accept this and if we have a Canadian economy that is not growing as rapidly as other economies in the world and, as has been pointed out, in certain fields the man who sits at the head office determines the investment flow and he is not going to be too interested in extending his investment flow in an economy that is stagnating. On the other hand, in Europe there is very rapid expansion. The profit returns in recent years have been in excess of 14 per cent in Europe as an average whereas it is only ten per cent in both

Canada and the United States. The basic precept, which I would hope we would accept, of a profit maximization would mean that it could be expected that the maximum investment flows would be to Europe.

Therefore it is a matter of touching the effort around the world. They are going to go to Europe, so in this case the American subsidiary instead of being most concerned how to change their position in Canada, will naturally try and do so in the facilities available, to have the capital from head office. Being directed elsewhere, then they may be without the wherewithal to try and meet their local problems. To try and quote specific instance in specific companies is obviously impossible.

COMMISSIONER GIBSON: What I am getting at is this. You are suggesting the sort of general economic motivations in a society or world where these things work out more or less perfectly. I think the kind of thinking you are putting forward is very well because in a general way but whether it actually works that way or not and how much there are other factors enter into it, I just wondered if you looked at it.

MR. CONWAY: The first assumption we made in this approach was that in the first instance we believe quite strongly that the attitude of governments in a period when there is not a crisis to provide jobs, cannot be to stand by and hope that just natural forces will provide a solution.

COMMISSIONER GIBSON: That is true, but I do not think you should assume that certain things happen just because they ought to happen

theoretically.

MR. CONWAY: That is correct. However, on the other hand, we are not willing to assume that because there is a chance you may not get exactly the desired result, that you will not take a certain move. You know from the way investment decisions are made within corporations to a certain extent by individuals, that there are certain types of tax laws, types of government action, that may reassure people or move in a certain direction. We don't know they will move in that direction. On the other hand careful investigation on these various lines is not devoid of information. Certainly it is far better to take a step that has a possibility of coming up with the result desired rather than taking no step at all.

THE CHAIRMAN: What is the step?

MR. CONWAY: The steps we have proposed here particularly, one of the major items was referring back to consumptions versus income. We felt that here, if you apply more taxation to the consumption side of the tax base --

THE CHAIRMAN: That means that you will reduce demand.

MR. CONWAY: Not necessarily. There have been quite a few surveys along this line. People, it has been shown, tend to a certain basic demand; their propensity to consume, shall we say, is at a certain level. It is very difficult to alter this.

Granting that somebody who we wanted to

consume the same volume, if you increase your consumption taxes it is going to cost you more. That consumption is something fixed, the number of dollars that you are going to have to consume a little bit less in volume.

On the other hand we will take the third one as balancing of your tax structure that does not have too much incentive, and say if you put the consumption tax on therefore that end is given a hard time, to say that at the present time we are taxing income excessively. This is our feeling. We are not taxing income in balance. If we bring these two items into balance, then not only are you placing dollars in the hands of the individual, his income taxes are lower, he then has a choice. He can consume his thousand dollars. If he does your demand in consumer goods goes up. If instead he determines to invest this, then supposedly your demand on the investment sector goes up.

We still feel it is a matter of capacity. If it is not too efficient capacity, the point is you may need to spend money even though you have not used the capacity to modernize your facility to compete in world markets. If you provide limits for companies to move in this line --

THE CHAIRMAN: You mentioned consumption taxes.

MR. GOODMAN: We propose an increase in the general manufacturers' sales tax of three per

cent.

THE CHAIRMAN: That is what you call consumption tax?

MR. GOODMAN: Oh, yes.

THE CHAIRMAN: Well, of course, lots of the provinces now have the sales taxes.

MR. GOODMAN: That is correct. At the present time consumption taxes in Canada produce less revenue than income tax in Canada, though not by intention. We are concerned in quoting a balance, and we have an example, although I do not like to keep referring to Europe because there may be other factors. However, they have been even more heavily leaning on consumer taxes because they are presently up to 70 per cent of the revenue in some countries. We have not found that this is an insurmountable barrier on the demand. We have found the incentive provided in lowering the income tax, and we certainly have some comments in Canada on this line.

Of course, if you have a productive investment in the investment sector, you do have a multiplier in your National Gross Product and therefore jobs. It is not necessarily the same as to the expenditures.

MR. CONWAY: The exact figures, this year the Federal Government are raising 47 per cent from income and 40 per cent from consumption, and our proposal would be that these should be adjusted to 45 per cent from income and 43 per cent from

consumption.

THE CHAIRMAN: You think it will sufficiently affect the economy?

MR. CONWAY: We cannot do it all in one step. This adding three per cent to the sales tax on consumer goods is going to affect prices, quite naturally. We would not want to see a sudden step of trying to pattern after some other machinery that would have other disruptions.

On the other hand, when you look at the income tax field, these percentages deal with very large figures. If the total tax revenue is approximately $5 billion, a small change is going to make a big difference in savings or disposable funds, the disposable funds of the individual.

You notice on the income tax change we are allowing a maximum rate of 60 per cent as an absolute maximum. There is some question whether this should be 55 or 60, but we felt at least down to 60. We have spread the rates right through, and the result for the lower, middle incomes by the tax of disposable income, will be around $2,000 a year. So although the shift in percentages is small, in absolute dollars the figures could be large.

Coming back to your first question by Mr. Gibson, the basic philosophy we had in approaching this was that first something must be done. We do think private enterprise is not doing

this. We are not here to remove the freedom of private enterprise to move in various directions. We want to make it possible for private enterprise to take action through a tax impetus leaving funds at their disposal, both individuals and corporations. However, if the action is not taken in the private sector, we feel it must be taken in the public sector.

THE CHAIRMAN: Yes, but the question we want elaborated is what should be done. As I understand it, you think there should be a shift from income taxes into sales tax. You may have some more points, but so far that is the only one I have been able to grasp.

MR. GOODMAN: We have the special depreciation allowance we propose which would be 50 per cent allowance in any year for class eight investment items, which are essentially the ones which would produce the goods in Canada, as an additional investment incentive. We feel you have got to look at what will be done with the government dollars that will be invested in social capital. They have not been withdrawn from the economy and they have obviously a multiplier effect. However, this is not all that we would have done had we been able to approach the entire economy.

MR. CONWAY: On the social capital question, in summary, we are increasing the consumption taxes, lowering the income tax, and to again net some revenue we are putting in a capital

gains tax the primary aim of which is equity but also to produce substantial revenue. We have the argument outlined in our brief. We do not feel this is going to have undue effect on capital investments. We have maintained our reasons. We realize there is an open question here but we have put forward our point of view. In the first place we propose that in effect this revenue goes with capital cost allowance which, if you increase it, is going to diminish government revenue. So specifically we are providing incentive to industry through the class eight machinery and equipment, making it easier for them, we would hope, to expand in this field of modernizing equipment. We are leaving more disposable funds in the hands of the individual who will be prone to invest this after the first year, and there is a chance revenue, as we pointed out in the summary, which starts to accumulate to the government. The 50 per cent investment realized is one year in two. It continues to achieve your savings the balance of future years. The company that buys machinery today gets an extra benefit.

This revenue, we have stated, should be invested by the government in broad term social capital, particularly, we had in mind education, technical research. I say that this has simply been discussed in Canada over the course of the last year more from the point of view of these are things that should be done.

The question has been where will revenue be provided to do this? What we have suggested here, is where we think revenue can be provided to do this.

So we are looking to the investment by companies in machinery and expansion and by government in education and training of workers, vocational training and general education, to up-date our technology on that side. Those are specific proposals we have looked at here. We also mention in our summary, although not in great detail in the brief, specific measures that we would do on the balance of payments side. We are most concerned that possibly this matter will be one of the major items your Commission will want to look at. We have not spelled this out in detail.

COMMISSIONER GIBSON: Looking at the tax proposals which you make and thinking of it in terms of one of your main objectives, that is to stimulate investment activity in the economy, the increased investment allowance or depreciation allowance (whatever you want to call it) this is obviously clearly aimed in this direction. You reduce the personal income tax, upper and middle brackets particularly. This might have an effect on investment, one would expect it would have an effect on investment, although in the lower levels it might affect consumption more than investment.

MR. CONWAY: Right.

COMMISSIONER GIBSON: You will put in a

capital gain tax. This, one would think, might work to reduce investment and indeed offset the changes you have made in the income tax. On the other hand it is a little hard to add this up as an investment stimulating programme. It has some of the features but does not have them all. For instance, why don't you reduce corporate income tax in your plan which is something that people that wanted to encourage investment have suggested?

MR. CONWAY: The corporations, I would feel, get their funds for re-investment not only from the cash flow which would be effected by reducing corporation taxes, but also through depreciation allowance. We prefer to be specific and pass the benefit to the corporations through a depreciation allowance, not spread out a certain amount of money which would be spread quite thinly and may not be invested, may just go into short term investments. We prefer to be specific and say that this is the amount of money we have produced in this one particular tax need and given to the corporation. We felt the best way to apply it was in the depreciation allowance rather than spread it over corporate income tax.

We are not advocates or we do not think corporation income taxes in Canada are too high. We are, compared to the under-developed countries of the world. Granted the laws of interpretation of it differ, but the corporate taxes in the United States are higher, in the United Kingdom are higher,

and in some of the European countries are higher or as high.

We feel there should be an impetus to corporations that want to expand, rather than have a general reduction in taxes of the corporations. It is a matter of direction to apply this amount of money.

MR. GOODMAN: Realizing that our class eight investment would be open to people who imported goods which might be produced here, we wanted to offset this, so we have recommended that these people - because our class eight investment is used to produce goods in Canada, to produce exports - that they not be given continued exemption from the sales tax. We have a very specific sector of the economy which we wish to stimulate.

MR. CONWAY: Therefore we apply all the funds just to that particular sector rather than spreading them out.

On the capital gains tax, I think one has to keep in mind that when you look at capital gains tax, as we have here, it is not capital gains tax as such. Capital gains is a certain method of taxation, but what you have to look at, it is going to have an effect on investment incentive, how it affects the individual, and the point that you are going to strike it down to the point at which naturally the person in the high tax bracket making $200,000 in capital gains, consuming $50,000

of it, consumption expenditure and re-investing $150,000, to writein capital gains tax he is not going to have as much money. This may not be accepted, but on the other hand we do not agree it is reasonable that this could not be adopted as part of the tax policy of the country.

Therefore we acknowledge, we have taken that money away from the investor, but we feel that the funds that we have remaining, funds he still has, and after all this is not a matter for imperical study but after all there is not much difference between Americans and Canadians in this respect, once a person has a pattern of investment it takes a lot to change the pattern that they are used to.

Therefore, we go on and say in the middle bracket people who have been taxed very heavily on their salaries up to a maximum of 80 per cent, we have felt it is unfair that these people bear such a large share of tax burden on the individual. Therefore we have said we will reduce their tax.

These people have got surplus money in their hands. We hope we have put through a small change in the tax system to increase the incentive for them to invest. If this is not an incentive, they will not invest naturally. We have a man that has another $2,000. If he consumes it we have increased demand.

However, sales taxes have gone up. If

he consumes it we are going to get tax revenue and the government will invest the money. However, if he chooses to invest, postpone his consumption and not pay tax through consumption, then we have some investment at that level. We have got him into the pattern of investment and we hope he would keep in this pattern. Granted, a lot of what we are saying is balancing this pattern and have been particularly put in to achieve equity. On the other hand, the net effect of his revenue, it can go into specific investment incentives.

COMMISSIONER LEMAN: I would like to ask you a few questions about the chapter dealing with financial reserves. In paragraph 35 here you make a statement that surprised me a bit. You say that the result of the way this area of reserves has been administered, is that there is a permanent reserve of more than 30 times average annual losses over the last 25 years, and that compared with the U.S. banks, you say they have been allowed reserves against losses of three times the average loss ratio of the previous 20 years. You seem to imply that the difference between the two systems is that the Canadian bank reserve, annual reserve would be about ten times as large as the American.

MR. CONWAY: I am sorry if that impression is given. That is not our intention.

COMMISSIONER LEMAN: How do you think they

do compare in fact?

MR. CONWAY: It is very difficult to try and compare banking systems in the United States and Canada, in that we have a branch system in Canada which covers the whole country and subject to excellent government regulations and regulation through the banks themselves for the branch offices. In the United States they have a lot of local banks that supposedly act in a degree under federal regulation, but those regulations in many cases have not been too effective.

As a result in the United States your loss ratios are much higher. In fact in the hearings they have held in the Banking Committee, it is made out that a substantial portion of the losses are from the results of fraud and defalcation.

It is very difficult to try and take a figure out of the air what a reserve should be as a proportion to annual loss. It is very easy to say: "Well, in the light of 25 years it is so and so". Should a bank be allowed that percentage, only two times, three times, 30 times? We are grasping to try and get some guide lines as to what should be allowed.

We can look at private enterprise operating companies, we can find that they have certain annual losses and that they have reserves tend to be a certain multiple. These generally range up to four to five times their annual loss experience.

You have got to look at the range of the assets involved, and there are so many problems.

When we approach the U.S., the banking system in another country, we would not hope to try and compare our own ratio, our own experience, because the systems are so different.

The magic number they happen to choose -- that three times loss ratio -- we did not just take that same three times. We looked at private companies in the finance field and saw what they had. Unfortunately, the statistics are not available in Canada as to the actual loss figures. It is impossible for us to work out the amount outstanding and come out and say that it should be four times or five times. What we are saying is that thirty times is too high, and we describe to you that in the United States they take three times. There are implications in this, and it was not necessarily derived from the accounting basis. On the other hand,private companies which have gone to the larges finance companies in Canada -- it is approximately three times. There is accounting justification in this, in that they have justified their actual loss experience. So, this was three times, put in merely as an indication of a ratio and not to say they are proportionately the same.

COMMISSIONER LEMAN: What made you arrive at a recommendation of three times?

MR. CONWAY: We arrived at that on the basis of what we have available as the loss ratio. This is the only fixed thing we have available. Those in the finance field, as it turned out over time -- their reserve just happened to equal about three or four times -- under five times, in any case. There is more risk in this type of loan, so we felt it was not unfair to apply the same ratio to the banks. We have also stated that if the actual estimated loss was greater, then quite definitely it would have to allowed. Unfortunately, there is not the information

available to let us know what is the estimated loss in proportion to their assets. They don't publish what their actual bad debt is. There are no figures to give us any indication of what this is as a proportion of their annual loss. All we have done is look at other companies in the finance field. We would not want to argue if someone said it should be four or two times, but we think that thirty times or even ten times is quite excessive. If we approach five, or under five, it is more difficult because the statistics are not available.

COMMISSIONER LEMAN: You make a statement here about the formula used in the United States, which I don't think is quite correct.

MR. GOODMAN: There is an amendment to it: It is the worst 20 years since 1927.

MR. CONWAY: Since 1927 to 1947 happened to be the worst, they all use it.

COMMISSIONER LEMAN: So obviously by going back to 1927 and picking the worst 20 years you get a different result than by taking the last 25 years, say, especially when you are in 1962.

MR. CONWAY: That is right. On the other hand, we don't necessarily feel that the period of time concerned -- we have not made any statement as to how adequate we feel the 20 years is. You can look back to the banking system in Canada and find out what happened there, and you will find during the worst period of the depression the banks in the net added to their inner reserves rather reducing them. You can look at private business and find out under current economic conditions what this amounts to.

As I say, then we stopped dead: We have got details in the United States, and taking the worst 20 years naturally gives them a higher figure, having a higher defaultation in this period.

MR. GOODMAN: The interesting point about the American banks -- we are not granting a complete comparison -- is that out of 13,600 banks, 6,504 -- almost half -- have such a small annual average loss that they are not able to make use of this provision, and they don't have any bad debt.

COMMISSIONER LEMAN: It is a little more complicated than that: There is the general reserve and specific reserves, for specific accounts.

MR. GOODMAN: We are only talking about the tax-free inner reserve.

COMMISSIONER LEMAN: Yes, but they are affected by the capitalization ---

MR. CONWAY: Are you talking about the Canadian system now?

COMMISSIONER LEMAN: Yes.

MR. CONWAY: The Canadian allowances set a maximum rate; that is the maximum for both the specific and the general.

COMMISSIONER LEMAN: That is right.

MR. CONWAY: Therefore, when we talk about a certain maximum here it does not make any difference whether we apply it to specific or general, because if you talk of the maximum it applies to the total of the two.

COMMISSIONER LEMAN: Not in the States.

MR. GOODMAN: We are trying to compare the two systems.

MR. CONWAY: We were just bringing up here the fact that in the United States, taking something in an actual loss, the amount they came to was three times.

COMMISSIONER BROWN: Plus specific reserves?

COMMISSIONER MACKINTOSH: Specific reserves are outside that?

MR. CONWAY: The specific reserves in the United States, when you get down to the annual loss ratio between banks, this is hazy in their interpretation.

MR. GOODMAN: You are right: We think we haven't been able to be too clear on this. This is the besides the specific reserves, and these 6,500 banks had specific reserves besides.

COMMISSIONER LEMAN: I don' think we want to get into a long calculation here orally to show this, but I think your brief leaves the impression that the inner reserves in Canada are much higher by comparison with the Americans than they really are.

MR. CONWAY: No, we are not trying to compare the reserves in Canada with the United States. The two systems are not parallel. We have tried to take one item in the United States and point out that Canada has a straight economic system. The Canadian banking system is relatively unique and we would prefer to compare the banking system in Canada with the finance ratios in Canada -- and general business companies. We specifically have not gone into more detail in the United States systembecause it is so impossible to compare with their system.

THE CHAIRMAN: On the other hand, you have, to anybody reading the sentence, done exactly that.

MR. CONWAY: Right. We have picked one ratio that they have used. We have not tried to say total reserves.

THE CHAIRMAN: But the impression left is that there is a very wide difference.

MR. CONWAY: What we are comparing is the three with the thirty. You feel the wide difference in the United States is, in effect ---

THE CHAIRMAN: I don't know, but reading that I thought it is a very substantial difference and that that was the point you were making.

MR. CONWAY: That is right, there is a substantial difference. The point we are making is between the relative reserves of the two banking systems.

MR. GOODMAN: You have to look at it in the entire section where we have dealt with the reserves. We are looking at the Canadian tax-free inner reserves and saying, what are they being used for, what are they needed for, and what is a proper amount to grant. There is such sketchy information available we have to grasp what comparisons we can. We took private business and said that if the banks want to go down count by count and check all bad debts, or right. We looked at the others to see what was a reasonable ratio. We looked at the Americans what number they are using. We did not intend to make any comment about the size of Canadian tax-free innner reserves as compared to the American.

COMMISSIONER LEMAN: I don't want to labour this any more than it has to be laboured, but I want to point out ---

MR. GOODMAN: We are sorry about the implication.

MR. CONWAY: There may be misinterpretation here, but we would still want to later discuss, if you felt it necessary, this one item of the three times we are using, which is one specific example of many examples. We do not agree because there is some question of a low level that thirty is reasonable. We have mentioned specific reserves ---

COMMISSIONER LEMAN: Well, this goes on the record and I just wanted to put that on the record.

MR. CONWAY: I am sorry we gave you that impression. On the matter of information, we have available the Bank of Canada figures and we have used those and there is a number of ways of using the Bank of Canada figures. There are varying degrees of information in the Bank of Canada figures shortly after 1954 and recently, which, by cross-checking the two sets of figures you can come up with specific figures. We have got releases by the Inspector General of Banks which details how the maximum is computed. It is not public information, but it is request and it is possible to get this percentage and give specific answers. We are able to go down and say that this is an estimate of the amount of permitted reserves at the present time. Here again, the information is not absolute because we don't have the foreign assets of the banks. We only have what the American banks have issued in that regard. We have

information here on the States,and we can see what has gone in and out. We have tried to put these in and see how it fits, and then we have a tie-in with the guide lines as to what seems excessive and what is reasonable. We are mainly trying to work down, and it would appear to us from what information is available that thirty is excessive. We certainly would not be able to argue with the evidence available that three is the magic number that can be applied.

COMMISSIONER LEMAN: With all this reasoning and information you had, or thought you had, you came up with your opinion that three times average loss ratio for 25 years would be the right figure?

MR. CONWAY: Or the actual, whichever is the larger.

COMMISSIONER LEMAN: And that leads you to figuring that you would like to get back $100 million from the banks?

MR. CONWAY: $150 million.

COMMISSIONER LEMAN: $ 150 million, yes. I would like to ask you two questions in relation to this conclusion, which is a conclusion based on an opinion. The first question is, suppose that the inner reserve or the total reserves of the banks , based on your opinion, would, in their opinion, be insufficient: What do you think the banks would do?

MR. CONWAY: They could carry on providing in the method that is sufficient to protect the deposits of the shareholders. All we are saying is that we do not feel they should get a tax advantage not available to other portions of the business. The banks have to provide what they feel are adequate

reserves. The question for government is, are they going to tax all segments of industry in the same manner. Can some segments fall outside that and get certain tax benefits, and we are not questioning this, but we have picked out one particular ---

THE CHAIRMAN: You are not only questioning it but you make some very bald statements about it.

MR. CONWAY: This is correct.

THE CHAIRMAN: And then suggest that you have not got enough information.

MR. CONWAY: We haven't got enough information to tie down whether these inner reserves, say, are $320 million or $380 million. We know within a range -- again, we can only take what is available -- but we are able to determine what would appear to be the maximum. We have the full information on this other than the foreign assets. Then we have to make the assumption as to what amount the banks' reserves are in proportion to this. We can only take what is in the annual reports, transferred in and out of inner reseves. But if a bank is transferring money in and out of tax paid reserves, or from inner reserves to accounts and paying taxes on it, there is every likelihood their inner reserves are at a maximum. Banks may be paying more taxes than they have to. This is a possibility we are unable to ensure looking at the material available. At the 1954 one of the banks stated they were at the permitted maximum, so this gives us the proportion of the permitted maximum of reserves at the end of 1954 that we know. We also know the transfers in and out of these inner reserves since 1954, because this is public information from the

Bank of Canada. Where we have sketchy information, is where we tried to do two or three sketchy approached and get all our approaches coming to the same figure. We lack one bit of information, but we come to the same approach. Then, with the top added amount that is in excess of $300 million, we found it was reasonable to make the statement.

We would be quite willing to go into detail but people through the Bank of Canada reports are quite aware of what is there. It would be quite proper for someone to try and argue that it should be something under $100 million. We feel with the information available it would be most difficult to argue it would be under $150 million but we included that under that narrow realm of $140 million to $190 million. We could not tell you the figure, we just do not have it available.

COMMISSIONER LEMAN: Anyway, as a result of your exercise you have ended up with what you think would be a windfall income for the federal government of $150 million?

MR. CONWAY: Not a windfall so much as a means of securing a windfall for the federal finances.

COMMISSIONER LEMAN: And then you suggest you would give the Finance 10 years in which to amortize this or pay it off and from there you jump to two purposes you would like to use this for -- mortgages and small business loans. Didyou go from the windfall into the two purposes or did you start with the purposes and look for the windfall?

MR. CONWAY: We were not sure at the time we prepared the brief just exactly what the scope of this Commission was going to be. The brief had to be filed prior to the time the Commission held any hearings. The material we had available when we asked the Commission secretary was that we could make all the submissions we wanted to, naturally, but it would be up to the Commission to determine whether they wanted to discuss particular points. We were

most concerned that these were two areas that should receive discussion and to try and tie them in we brought them with these sources of revenue. Quite definitely we feel they stand alone. On the other hand we feel there is a connection in that we would be looking to a great extent to the banking system to develop this money from small savings.

We are trying to show here, if the argument is made which could be made if we are going to take a sizeable amount from the banks how are they going to perform the function -- we are trying to say that it could be said that the money would be used for particular purposes and we are going to maintain the banks' position and help the banks in their loaning activity. If we came down to the one that was cut off, i.e. resources, we would not say this was desirable.

THE CHAIRMAN: Well, if the banks have received more money than they should have received and set aside as inner resources and that $150 million should be released from these resources why should it be applied to any particular project? Why should not it go into the general government revenues?

MR. GOODMAN: It could go into it quite easily. We tied this together for convenience sake. But if you decide that mortgages and small loans ---

THE CHAIRMAN: Well, if you were right in your proposition that means that the general revenue of the country would definitely pay the $150 million?

MR. GOODMAN: That is correct.

MR. CONWAY: And it so happens we have a

particular programme in mind that would cost the general revenue $150 million.

THE CHAIRMAN: And the business of the mortgages is a separate proposition entirely that would come out of general revenue?

MR. CONWAY: That is correct.

THE CHAIRMAN: But the money never could be applied on money for mortgages?

MR. GOODMAN: But we did not want to propose anything that would call for deficit financing on this. We could say this is another point that we do not confuse with a deficit programme.

MR. CONWAY: We are not raising the issue of deficit financing.

COMMISSIONER GIBSON: But if they are worth anything they are worth doing?

MR. CONWAY: That is correct.

COMMISSIONER GIBSON: What sort of study have you made of the need for this particular amount in this area? As you know there has been a small business loan arrangement set up six or eight months ago, maybe ten months ago. This is in operation. Now, what is the matter with that? You have mentioned that you do not think this goes far enough?

MR. CONWAY: That is right.

COMMISSIONER GIBSON: Are you satisfied that there is an additional real need to be filled here? Have you studied the results of the loans that have been made under this recent Act?

MR. CONWAY: From what information is available we have. Personally we feel that two of the limitations are, first, the definition of a small

loan and, secondly, the amount of the loan and if these loans are to be arranged by the government they would have to put up some funds to guarantee the banks against potential loss but we feel that a good proportion of this money primarily is going to come within the limitations so there is a great need for increasing the limitations so that larger loans could be made. That is from the side of providing the fund. Quite naturally if the economy is not growing, if there is not any opportunity for profitable investment the firms are not going to borrow the money. Just having the money there does not mean that people are going to run in and borrow it.

COMMISSIONER GIBSON: You are proposing that here we have an economic programme but we do not have surplus resources just waiting around to be used by anyone. If this country wants to try a big addition to an economic programme or a big change we have got to be satisfied this is one of the best things you can do in this set of circumstances. I do not think you have fully explained why this is so. We have looked at the small business loans arrangement. It seems to be working well but a relatively small part of the total monies have been taken up as yet.

MR. CONWAY: That is correct.

COMMISSIONER GIBSON: It seems to me it is up to you if you are making a proposition of a general nature which you are interested in and would like us to consider, we would like to know a little more about the evidence to suggest that it is a good

thing?

MR. CONWAY: As mentioned earlier we cannot go into all the details here to explain what we have done. As mentioned, we feel particularly within limits that there was some opportunity there. In view of what use has been made of the programme so far it would be hard to say that the banks had approached this programme with reluctance. On the other hand, it is possibly not so hard to say that this programme has not been emphasized or publicized or pushed by enough information as greatly as it may have been possibly.

COMMISSIONER GIBSON: Well, that is a sort of an innuendo with nothing to back that up.

MR. CONWAY: We have not conducted a detailed survey.

COMMISSIONER GIBSON: I see no evidence of that.

MR. GOODMAN: The main evidence we were going on was not based on this most recent act because at the time we presented this we did not have any time to study it as we would have liked to. We had the figures on loans between October, 1956 and October, 1957 which covered the shift from easy money to tight money and firms with more than $100 million in assets had 60 per cent more of a complete shift and in between the firms fared in conformity to their size.

THE CHAIRMAN: What does that prove?

MR. CONWAY: If we have a banking system as it stands today and the banking system is a private enterprise that is operated not only for the public

economy but the private profit for the shareholders quite naturally we feel that as between the maximum interest rate and the lowest interest rate it is quite right that a bank manager faced with two or even ten requests, one for the delivery of $1 million which is going to produce 5½ per cent revenue and offsetting this ten requests for loans of $100,000 each, he has in mind his responsibility of providing credit to improve the economy but nevertheless there is the side issue that in respect to the larger loan he will have virtually the same revenue and he is going to have less administrative cost.

COMMISSIONER GIBSON: That is not the way the system works. Banks have branches throughout the country and the branches are each judged by the way they can make a profit. It is not as simple as you suggest.

MR. CONWAY: I am sorry if I suggested this was simple. There are a number of things to be considered as to the way the loans are made. We have not made any recommendation here on a maximum interest rate. We feel 6 per cent may not be an excessive rate but we realize if the government wants the banks to make more loans it must step in and guarantee the banks to protect them against the risk. So we say that in spite of anything that has gone on to date we feel it is important, this providing of the banks with the insurance guarantee that they can take this risk. We must have the publicity as an attraction to get the firms knowing this is available and then it is a matter of having a growth in the economy or a demand in the economy so the firms want to borrow

the money. It is unfortunate in our system in Canada that many small firms feel they cannot go to the banks and there have been surpluses of this money recently.

COMMISSIONER GIBSON: For what kind of money?

COMMISSIONER BROWN: I think what you are getting at is a loan requires both a lender and a borrower. What evidence have you that there are lenders who won't be satisfied?

MR. CONWAY: One might have would-be borrowers who are borrowing from some other sources. You have borrowers who are borrowing from sources at higher interest rates; you have borrowers who are taking loans from finance companies, sometimes borrowing at 8, 9, 10, 11 per cent who are borrowing at higher rates of interest than the bank interest rate. Now, these particular people have looked at a particular investment and decided they will go into this and it is worth paying 10 per cent or 11 per cent to go into it. If the borrower decides he can spend so much on investment and make so much profit at 10 per cent, we do not think that is an unfair presumption to assume that he could borrow at 6 per cent or 5½ per cent under the Small Business Loans Act.

COMMISSIONER BROWN: What is the size of all this?

MR. CONWAY: We are saying here it is impossible to know the size. However, you just have to have the means available and within the economy to get the demand. It is absolutely impossible to survey the economy and say that $2 million or $2 billion

could be borrowed and spent on the small business loans but where the investor decides -- the person borrowing the money and buying equipment knows what it is going to cost and he is quite willing to accept a lower yield and therefore will expand more rapidly into other areas.

Now, with the banks at the present time these people cannot go to the banks to a great extent because they can only borrow on their receivables and they are borrowing then for machinery and that type of thing and this is why the Small Loans Act came in -- to borrow at a low interest rate from a man close to him that he has already borrowed from on his receivables.

We understand that the limits at the moment are for an individual to borrow up to $25,000 within the definition of "small business". We say if you widen this you will have more people who want a loan. Therefore, you have the government guarantee the banks against loss and that is why we are putting this in.

I would question even that the banks with the resources they have available could estimate the exact demand. On the other hand, you could compare this with machinery and everything going out the other side as well. We hope all this will get the people looking and seeing if they can invest more.

COMMISSIONER LEMAN: How much judgment should the bank exercise in granting this type of loan if they are automatically guaranteed by the Federal Government?

MR. CONWAY: My understanding is they are not

guaranteed under the present Act. There is a certain limit on the amount. The insurance fund has a certain limit.

MR. GOODMAN: 80 per cent for equipment and 90 per cent for premises.

THE CHAIRMAN: You suggest that that should be extended?

MR. CONWAY: Well, the present Act sets it at $30 million to provide against losses. Once that is gone it is the bank's loss.

THE CHAIRMAN: But your suggestion is the government should guarantee ?

MR. CONWAY: No, we state they should increase the insurance fund from $30 million to $130 million.

COMMISSIONER GIBSON: So on the same basis that is being done now but the limit is raised?

MR. CONWAY: That is correct.

COMMISSIONER GIBSON: You are not saying that your amount has any particular validity; you would like to see some stimulus given in this area.

COMMISSIONER BROWN: It should be greater.

MR. CONWAY: Perhaps that could be governed by the demand, but take it to $100 million. We do not feel the $100 million is excessive but there might be much demand.

COMMISSIONER BROWN: Could the I.D.B. not take care of that?

MR. CONWAY: The I.D.B. is helping to a certain extent in that fashion although they have gone into much larger loans. Many of these people

are also borrowing from the banks and it is just a matter of increasing their growth. Here again by providing the means to borrow at less interest because we say if you do not provide the means and publicize the means how can you expect the people to look at the possibilities and opportunities? That is our proposition but we cannot just drop off the means.

COMMISSIONER BROWN: I think the I.D.B. averages somewhere between $50,000 and $60,000.

MR. CONWAY: That is their average. However, they have a considerble amount of loans in higher figures, over $100,000, $200,000 and larger ones.

COMMISSIONER BROWN: But they must have a lot of small ones.

MR. CONWAY: That is right. Of course, many of these loans were brought out before the banks got into this field. So you have two outlets providing the same thing. That is twice as good a reason why the people should know the outlet is there and make use of it. We do not see any harm in competition from I.D.B.

MR. GOODMAN: Did you want us to go into the reasons for the mortgages as well?

COMMISSIONER MACKINTOSH: I have some interest in that. This would at some juncture be an improvement in the capital market. How does it fit in with the growth and employment objectives limited as it is?

MR. GOODMAN: We find sharp cyclical swings in housing. Farm growth, we cite what happened in 1959 and 1960, the first and mid-year surveys in investment in the 1960 projects, a sharp increase

over 1959. It turned out in the end of the year totals we found a sharp drop but the reason was almost solely due to housing expenditure.

We calculate that one of the reasons for this sharp cyclical swing is that there is a sharp division between new houses under the N.H.A. and old houses which certainly do not have any guarantee to them. We do not calculate that the buyer -- you have pressure coming for new houses under the N.H.A. from people who may be selling their old houses. If they cannot get a buyer for their old house they cannot go into their new house. What we are proposing is that some form of insured mortgages be available for used houses. The facts we found concerning a lot of this came from a book which is just about to be published which tries to look into the secondary mortgage market and used house market with a lot of imperical surveys which are generally interview types. We find that people, when they were not able to obtain a reasonable rate, given the economic conditions, that they rented rather than purchased which permanently postponed their borrowing and rather than have these higher interest rates we would suggest using what is a limitation in a small amount of money and what is a good administrative programme now that these funds be created to balance new house mortgages by insuring used house mortgages or by providing used house mortgages. Once you have this smoothed out so you have a more integrated mortgage market -- and I gather there would be more steps required than this -- if you can smooth the wrinkles out, the sharp wrinkles,you automatically have more certainty

when it comes to investment for the future years.

I think we can estimate figures, looking at the former years, guided by what the population was which this embraces and what the investment will be, what the various types of spending will be. Presumably this is one of the reasons the government publishes this survey. I think then the people will be quite willing to provide investment which I feel is an essential part of growth.

COMMISSIONER MACKINTOSH: The distinction which you draw between this and growth is that you feel the large specific factor at the time of the building of new houses is the inability to sell old houses?

MR. CONWAY: The first reaction could very well be that if you make the market available for used houses the first instant reaction would be someone looking at a new house and possibly they could get by at a lower cost on an old house and the result is that the new house market would have some demand transferred to the used house market. On the other hand, we feel as well there is a demand for housing as opposed to apartments and if you prepare the way for people to go into old houses in the end your demand for new houses would ultimately increase or certainly smooth out.

Again, we are getting at the equity of the situation. We have made our proposals but only on the growth. After all, we have to look at the present time. There has been inequitable development in the system over the years. There is a major inequity now in the problem people find themselves in with

high cost second mortgages, the difficulty of getting financing for housing. So even if there was not any expansion we feel the proposal would still stand on its merits on the basis of equity.

COMMISSIONER MACINTOSH: I think it has merit as a suggestion for improving the mortgage market, and it has merit as a means of improving mobility of people who are often held up by inability to sell a used house, and people newly coming to an employment and finding difficulty in acquiring a house because they have not the much larger cash payment that is likely to be demanded on a used house. You put it in a smooth pattern.

MR. CONWAY: Well, on the basis that if the proportion of the population at the present time living in apartments, if the proportion shifts so you have more living in houses because they have the means to move into houses, this requires greater expenditure on the part of population in going into a larger type of residence, and this greater expenditure in itself would be a stimulus, yes.

COMMISSIONER MACKINTOSH: Yes, on the assumption that you will have an apartment of a certain type and acquire a house of a certain type, but beyond that I could not say.

MR. CONWAY: That is correct. Even if a person is spending the same amount of money in a house, the $100 a month breakdown between interest and principal, that enables him to get a certain quality house, and with that same $100 if he can get into a larger sized house there is greater expenditure on construction.

COMMISSIONER MACKINTOSH: Maybe a little

tenuous.

MR. GOODMAN: We feel the other arguments have more merit.

COMMISSIONER BROWN: I am wondering about another question that you do not deal with specifically in your brief, and that is you do not mention the possible problems of capital flow and inflow in the international sector. Can you give us your opinions on the floating exchange rate or fixed exchange rate and how you think one or the other would produce the movement you hope for?

MR. GOODMAN: Well, on international monetary funds the experts who come from Harvard, and they happen to be our teachers, are inclined to say, "You nasty Canadians, you are beggaring your neighbours with this", but our own thinking on this is we have to go upon a fixed exchange rate, that this is first of all fair and international. We ask for a certain amount of time to iron out a domestic economy. Whether the Government has just been smoothing out day to day affairs or whether it could not have been manipulating a little bit, is a matter every international investor is going to decide on his own. To our mind, once people begin to think you are manipulating the exchange rate, whether you are doing it or not but if people think you are, you run the terrible risk of this crisis of confidence, as we try to emphasize, because this has been one of the reasons we feel this problem of the balance of payments is one that

we will be facing very shortly.

Now, if we peg our exchange rate at a proper international figure, one that accurately reflects the buying power of the Canadian economy, it is neither over-valued nor under-valued with respect to other countries, we provide an economically most efficient method of making an economic choice both by foreign investors and by domestic investors.

In sum and substance, we came to the conclusion that the exchange rate should be fixed and will have to be fixed.

COMMISSIONER BROWN: Leaving aside all the background that you might produce and the rest of it, what do you think from the purely Canadian point of view?

MR. CONWAY: The thing that concerned us from the Canadian point of view is that at the present time we have accomplished an excellent objective in our export-import balance in bringing the rate down, but the trends of the past particularly the last five or six years of foreign investment in Canada, the increase in payment of dividends and interest and shares, money flows into the country, have very nicely worked out to our advantage in that we have not had undue pressure on Canada, that the short term money flows have come along just at the very time that we have needed by increased payment of dividends. We are most concerned that this convenient balance may not continue.

The American government - and we cannot ignore the American government unfortunately because it has such a great effect - has announced the intention in a particular area of what they intend to do, having gone to the extent that both the President and Mr. Dillon have specifically introduced a measure they say is aimed only at Canada. In other words, they are claiming all the calls of the short term money into the country, and are entering in two measures, have entered in and are really proposing changes which we understand have every likelihood of getting passed, if nothing else gets passed, and these measures will have terrific effect on the Canadian economy, in that they are going to go for a figure upon a balance of payments.

Now, if we have this risk threatening us, then the question is how we are going to prepare for it. We feel there are two things. One, we now have a fluctuating exchange rate being supported with our exchange fund which has come down from over $2 billion to about $1.7 billion. This is a lower limit. That exchange fund, to support a fluctuating rate, if it takes a sudden drop, even a more sudden drop down towards more to the $1 billion, is going to create, could very well create a lack of confidence, create lack of confidence in the Canadian dollar and the Canadian investment picture.

So what we are now about in the floating exchange rate, which has been maintained at this

point, if there is a drastic outflow and there are problems maintaining that, our reserves go down and we are faced with lack of confidence. It may be better to settle the problem of the exchange rate, whether floating or fixed, before we have the situation forced upon us.

Second sight in our specific recommendations of this kind, are that if we know we are going to be faced with this we just cannot expect this present rate to continue that we have had to date. If we know short term funds are not going to at least increase as at the present time, it can be said that short term funds in which Canadian interest rates are mentioned, we are not going to get more short term money and we are liable to lose what we have.

Long term investments we have already discussed. Interest and dividends have been falling in the last couple of years, about three and a half per cent to the investment in Canada. This is a very low yield to the person who is investing in the country. Once he decides to pull out more of his earnings the figures can increase substantially. Last year we went up $100 million, 1960-61. So we are looking at our interest and dividends increasing, our direct long term investments being reduced, and our short term money which has balanced the books has been cut off by American direct legislation, and we are back to: What do we do?

We think first of the exchange rate.

Second, there should be some endeavour on the part of Canadian authorities to have the Americans postpone some of their measures. After all, we are not exactly causing the American balance of payments problem. In fact we are contributing to their stabilization for the balance of payments. We see very little reason why there should be direct American government action when we have to solve our own problem. We feel pressure should be put to postpone this particular item to get our houses better organized.

Thirdly, we felt that the government as well as naturally trying to get the economy going so that the investor wants to leave his money here, is going to have to be prepared to get into the long term money market to balance short term outflows of capital. The American market is discouraged from looking to our side and is encouraged again to look south of the border. We feel this is an area we should be following in the United States rather than forcing the exchange rate figures and the attendant problems to our local economy, and that they should be quite prepared to move their capital into this field, so that we do not have a big reduction which creates a confidence crisis. We have put this on a very, very high priority.

THE CHAIRMAN: Any further questions? Thank you very much, gentlemen.

MR. CONWAY: Thank you very much, gentlemen, for listening to us.

--- Addition to summary read by Mr. Goodman.

This is not to say that we disapprove of deficit financing under appropriate circumstances.

But our submission, while perhaps far-ranging, is still far from the entire programme we would prescribe to deal with the woes of the economy at this time.

Since our submission is limited, however, and since deficit financing is a separate issue, we suggest a programme with balanced revenues and expenditures.

Similarly the adjustments we suggest for the tax structure are only some of many proposals we would make were this Royal Commission attempting a comprehensive review of taxation.

We feel our proposals would be a sound part of any programme to cure the ailing economy, but we emphasize that many more measures are required.

Urgency is a basic tenet of this submission. We are concerned with the Canadian economy, which, in the final analysis, must be the prime concern of this Royal Commission, and we are particularly concerned with the tone of recent official assessments of the economy.

This is a tone of complacency, a tone of satisfaction that we do not believe is substantiated by the actual performance of the economy.

It is tragic, for instance, to accept as

fact that to have stable prices in Canada means 600,000 people unemployed.

It is irresponsible to profess satisfaction with recent growth when in effect it has been stagnation.

It is ludicruous to point with pride at our balance of payments when legislative action in other countries threatens to cut off the foreign investment which in effect finances our standard of living. Should this investment be redirected, we would have to take drastic steps to balance our international accounts. This in turn would be a stern constraint against measures that would be necessary to revitalize the domestic economy.

We have had exceptionally good fortune in our balance of payments. Higher interest rates combined with tax advantages resulted in a sharp increase of U.S. funds to Canada. For example, by May, 1961, $3,100 million was deposited with Canadian banks in New York, of which $700 million had been brought to Canada.

Last January, U.S. banks were allowed to increase to competitive interest rates, This is stopping the flow to Canada and may cause a reverse flow.

By the end of this year or the beginning of next, a revision of U.S. tax law is expected which will adversely affect the attraction of investing in Canada.

These changes are likely to be:

1. A change in the foreign tax credit provisions to remove the incentive to U.S parent companies to move short-term funds into Canada.

2. A proposal to include foreign real estate holdings in the valuation of U.S. estates for tax purposes. At present foreign real estate holdings are not taxed, and considerable U.S. funds have been invested in Canadian real estate.

3. A proposal to nullify the tax advantage of investing in Canadian non-resident owned investment corporations. There are at least 10 such corporations with about $300 million invested in Canada.

Meantime there has been a steady upwards trend in net dividends and interest out of Canada. These rose from $391 million in 1956 to $491 million in 1960 and then jumped sharply to $575 million in 1961. This represents a yield of only three and a half per cent on more than $23,000 million of foreign investment in Canada. The yield is less for equities since bond rates have been higher.

It would be folly to believe that U.S. investors will not soon withdraw a higher yield. The tax advantages will be gone. Our economy is in danger of losing its attraction compared to such dynamic areas as western Europe. President Kennedy is determined to use every weapon to balance U.S international payments, and the record of the past week indicates the forcefulness of the

President's will.

We are now getting what amounts to a free ride -- covering outflow with foreign investment -- but we should not be decided by a current balance.

We must be prepared for the inevitable loss of this short-term crutch. If we are not able to meet an outflow of dividends and interest, a confidence crisis will result and there will be an outpouring of principal.

We believe these problems need immediate consideration and action. This Royal Commission should provide the guidelines for government action and leadership.

In the more limited areas touched on in detail by this submission, we begin by examining the chartered banks.

SUBMISSION BY MR. FRANK O'HEARN

THE CHAIRMAN: The meeting will resume. Mr. O'Hearn.

MR. O'HEARN: Mr. Chairman, and members of the Royal Commission. I wish first of all to take this opportunity to thank you for taking in my brief and supplement and for giving me this opportunity of a public hearing. I must say that this is more than the House of Commons and the Senate Committee on Banking and Commerce did for me, when I submitted a similar brief before them back in 1954 when the bank charter renewals were under consideration by Parliament. At that time --

THE CHAIRMAN: Mr. O'Hearn, you may read your brief, but we expect you to confine yourself to your brief. If you read it first, and then there may be some questions.

MR. O'HEARN: I have in mind making some suggestions that might save you some --

THE CHAIRMAN: No, we have all read your brief, and if you wish to read it you may, that is, the summary of the brief.

MR. O'HEARN: Just the short summary?

THE CHAIRMAN: Yes, the first two pages.

--- Mr. O'Hearn read the first two pages of his brief.

THE CHAIRMAN: Thank you, Mr. O'Hearn. Any questions? If there are no questions, thank

you very much, Mr. O'Hearn.

SUBMISSOON OF THE COMMUNIST PARTY

OF CANADA

APPEARANCES

Mr. L. Morris
Mrs. P. Clarke
Mr. N. Clarke

--- Mrs. Clarke reads summary.

THE CHAIRMAN: Are there any questions? Apparently there are no questions. We have all read your brief thoroughly and appreciate very much having you submit it.

MRS. CLARKE: Thank you.

SUBMISSION OF MR. A.H. CAMERON

MR.CAMERON: Mr. Chairman, this is rather a long brief, and it has been in your hands and I don't propose to read it.

THE CHAIRMAN: Have you a summary?

MR. CAMERON: Yes, there is a summary at the beginning. If you wish, I shall read it.

THE CHAIRMAN: That is under "General Remarks and Recommendations"?

MR. CAMERON: Yes, sir.

THE CHAIRMAN: I do not think it is necessary for you to read the whole of that. We have all read this. If you wish to make certain general comments and leave the way open for questions, if that suits you.

MR. CAMERON: Very good, sir.

THE CHAIRMAN: Whichever you prefer.

MR. CAMERON: The gist of the general remarks and recommendations is that I think the financial system is suffering from a bit of a malaise which is developing certain cracks. The root cause of this is probably what people have done to money over the last three generations and the suggestions which I would make are not going to solve this problem; they are merely suggested corrections in the machinery in the central bank area, in the finance department and in the operations of the capital markets which might make the system function a little better in the conditions under which we live.

Since you gentlemen have read the brief and the suggestions contained therein I would not wish to take up your time by reading it any further and will await any questions that you might have.

COMMISSIONER MACKINTOSH: I have some questions, Mr. Cameron, on your interesting brief. You have some proposals concerning the Bank of Canada and particularly the board. If I recall you suggest quite a small board sitting perhaps two or more days a week. I was wondering if this was not getting near substituting a committee for the governor of the bank. I was a little uncertain as to whether this was a board or a day to day management committee. Would you care to comment on that?

MR. CAMERON: Possibly it would turn out to be closer to a management committee such as the Bank of England has, sir.

COMMISSIONER MACKINTOSH: Are you thinking of the Treasury Committee of the Bank of England?

MR. CAMERON: Well, there are four full time directors --

COMMISSIONER MACKINTOSH: They are executive directors.

MR. CAMERON: Yes, sir. There are 12 part-time directors who are around the bank at least once a week and sometimes more often. Quite a few of them are people with banking experience. I think at the time of the Radcliffe Report three of them were members of merchant banks, one was the head of a small clearing bank, one was the head of a bank doing business abroad, mainly in South America, most of the other seven represented industry, insurance, trade and shipping and trade unions.

What I had in mind was that Ottawa is fairly convenient to Toronto and Montreal and it might be possible to have as directors of the bank and available two days a week people of a financial or academic background who could advise the governor as to what was going on in the financial community as well as what they thought ought to be done under any given set of circumstances. They would assist the governor if he had some points

that he wished to make to the government and at the same time if the governor got off on the wrong foot with some idea they might be able to be a brake on him.

COMMISSIONER MACKINTOSH: You would, I take it, abandon the regional representatives, would you?

MR. CAMERON: Yes, sir, I feel that the meetings of the board have been rather infrequent and that -- I don't know because I have never been to a bank board meeting but I understand that quite often the proceedings consisted of the governor perhaps advising the board rather than the other way around, as to his view of the economy and therefore that the regional representatives perhaps did not contribute very much to the operation of the bank other than to provide a facade for the government.

COMMISSIONER GIBSON: Do you see these new directors that you speak of as active directors spending a couple of days a week but not full time; in other words, they would not be executive directors, they would not have a particular share of responsibility?

MR. CAMERON: No, sir, I would look at them as being not full time employees but rather elder statesmen.

COMMISSIONER GIBSON: Available on an advisory capacity at a policy level?

MR. CAMERON: Completely advisory but at

the policy level and also as sources of information.

COMMISSIONER BROWN: Would these be people who had retired from other organizations?

MR. CAMERON: Not necessarily, sir. The Bank of England manages to justify using at the time directors who are still active in a merchant bank, in one case, in another case in a clearing bank, in another case a foreign bank. We had as executive directors in the Bank of Canada an instance of a general manager of a life insurance company who is not retired. In the case of the Nederlansche Bank they have two directors who teach in the school of economics two days a week. I do not have in mind quite the counterpart of the Federal Reserve Board where the members are full-time.

COMMISSIONER BROWN: No question about any conflict of interest at all?

MR. CAMERON: The English had a committee of inquiry after a change in the bank rate some years ago to see whether there had been a conflict of interest in the position of some of the directors vis-a-vis their own institutions when they were made privy to the knowledge that the bank was going to change the bank rate and I think it is fair to say that the directors were exonerated. I think you would be able to find people of equal integrity in this country.

COMMISSIONER MACKINTOSH: You would not think of a board slightly larger than you suggest

with some regional representation and an executive committee of the sort you suggest meeting much more frequently plus perhaps some executive directors who in the case of the Bank of England are officials of the bank?

MR. CAMERON: Well, that might solve the problem, sir. I really felt that the present board were rather remote from the operation of the bank and that the bank would benefit by having some structure of advisors whether you want to call it a board or a court or executive directors.

COMMISSIONER GIBSON: You are not proposing to reduce the executive power or the power of decision of the governor, you want to give him more continuous advice, is that a correct statement?

MR. CAMERON: I think that is how I would prefer it, sir.

COMMISSIONER BROWN: How do you visualize the relationship between this board and the government in the week to week operation of the bank?

MR. CAMERON: I do not suppose it would differ very much from the present executive Committee in the government except that having more people who are not government employees full-time on the board they might be able to speak a little more forcefully if circumstances so required.

COMMISSIONER LEMAN: Mr. Cameron, in answer to Mr.Gibson's question I believe you said

you did not want to reduce the authority of the governor but provide him with more advice. Nevertheless, reading your brief I got the impression that you would like to reduce considerably the area of decision of the governor. For instance, you say let us have the department of finance outside the whole area make the whole set of decisions in the area of debt financing. Therefore, you would take that away from the governor?

MR. CAMERON: Yes, I think it could be hived off as a responsibility of the finance department and certain other things which may have been done without legal authorization in the past should be either legalized or prohibited.

COMMISSIONER LEMAN: Therefore, shouldn't we gather that on the whole you would like to reduce the overall authority of the governor?

MR. CAMERON: Or legalize it in areas where it has been used in the past without specific legal authority. But this would not have a bearing on the presence of extra directors reducing the governor's power.

THE CHAIRMAN: You are of the opinion that the functions that have been performed by the governors should be legalized. Do you think they should be legalized or do you think he should be shorn of those functions that he has been performing according to what you suggest without legal authority?

MR. CAMERON: I think this is a matter in some cases, sir, when they should be legalized and in other cases that they should perhaps be prohibited but in any event that the area for the use of moral suasion should be reduced.

COMMISSIONER MACKINTOSH: Upon another point that you raised here, the responsibility of the bank to the government, you suggest that this should be specified in the statute? Have you any judgment as to whether the terms of the British Act would be adequate or do you wish some further enactment?

MR. CAMERON: I think the British Act does specify enough that there would be no likelihood of misunderstanding arising in the public's mind as to what is the policy of the Bank of England or that of the government. In fact, one of the chancellors went so far as to refer to the bank as "my creature".

COMMISSIONER MACKINTOSH: You would agree that there should, however, be some residuary independence of the bank?

MR. CAMERON: That is correct.

COMMISSIONER MACKINTOSH: This is one of the cases where you have to try and accommodate two incompatible situations. There must be both responsibility but also independence of view if that is to be achieved. It cannot be logical but in preference it can?

MR. CAMERON: I think also to put it in

another way, as I have said in the brief, you should never have a situation where a Minister of Finance can play Pontius Pilate and say: "The bank is not my creature, I am not responsible for it, we accept no responsibility."

COMMISSIONER BROWN: In cases of dissidence in policy, there would be a presumption that the government policy should prevail?

MR. CAMERON: Yes, sir.

COMMISSIONER BROWN: The question arises should this be done by way of public directive so that everyone knows there has been disagreement and what has been the decision?

MR. CAMERON: I think Mr. Towers was of the opinion that if there was disagreement which could not be resolved by private conversation that the governor ought to resign. Possibly there is something to be said for having this direction wielded privately rather than publicly.

COMMISSIONER GIBSON: If you cannot state it privately then the government would presumably give a directive to central bank and the governor, if he disagreed, would resign at that point?

MR. CAMERON: Yes, but there are provisions in the statutes of five or six different Commonwealth central banks that lay down rather alternative procedure if there is a disagreement but I do not recall specifically that the orders have to be issued publicly.

COMMISSIONER BROWN: This is one of the

important points, I think, is it not? There is no longer an automatic control of monetary inflation and I would just like to get your opinion of the extent to which it is necessary that the public be informed if the government is using the central bank to further political ends rather than economic.

MR. CAMERON: If the governor went along with it I guess you would still have to rely on somebody interpreting the sense. If the governor did not go along with it his resignation would be as Mr. Towers once put it, "A red light".

COMMISSIONER LEMAN: I can understand this is the real object. There is here a further step. When Mr. Towers made his statement there was no provision for a government directive. He simply said on disagreement the governor should resign. If you are going to provide for a directorate then I do not think you should assume that being issued a directive by the government the governor should then automatically resign. There is not much use issuing a directive if that is the only result of it. I would assume the governor would consider whether he could in integrity carry out the directive and if he could not he would resign. But the degree of absolute approval in these areas is often not very high and I can conceive of many circumstances in which the governor having argued against the directive could, in good faith, carry it out when the government had made

the decision. In other circumstances he would not. But just the issue of a directive which had the automatic result of the governor resigning it seems to me would shorten the process.

In this connection, Mr. Cameron, you suggest that the Act itself should specify the governor's tenure of suspension and grounds for removal. What did you have in mind there? What kind of grounds for removal did you have in mind?

MR. CAMERON: The present act, as I read it, sir, does not specify any.

COMMISSIONER LEMAN: Then you would start with gross misconduct perhaps. But how far would you go? If you imagine this mechanism you have just described about the resignation of the governor under certain circumstances, is that what you have in mind by the expression "grounds for removal"?

MR. CAMERON: That is correct, sir, but I think it would be in the public interest if we were able to avoid a repetition of recent events. I am sure that if the government felt that it no longer had confidence in the president of the Canadian National Railways that a method would be advanced to abrogate his contract without a full debate in Parliament and the committee of the Senate holding a hearing.

COMMISSIONER LEMAN: Could you be fairly specific on what you would suggest as grounds for removal to be stated in the law?

MR. CAMERON: I would think loss of confidence by the Governor in Council would be sufficient grounds.

COMMISSIONER LEMAN: Isn't that pretty close to saying the Governor's tenure is subject to pleasure?

MR. CAMERON: That is practically the same thing.

COMMISSIONER BROWN: This would be done without any public discussions?

MR. CAMERON: I think there would be some public discussion.

COMMISSIONER BROWN: You say you wish this done without any discussion in Parliament or the Senate: Where would there be public discussion?

MR. CAMERON: There would be questions raised and some sort of debate, no doubt, but perhaps it is too much to hope for, but I don't think we should be treated to another 1961.

COMMISSIONER GIBSON: Going back to what Dr. Mackintosh said, it seems to me you are almost suggesting that if the government were to issue a directive the Governor would have to resign because this would indicate there was disagreement. Isn't the degree of disagreement important in this? I think we are all feeling around on this particular point.

MR. CAMERON: I would assume that if the Governor resigned he would issue a statement on the area of disagreement which would elicit one from the Cabinet -- the Minister of Finance.

COMMISSIONER GIBSON: But suppose a directive were given to the Central Bank to the effect they were to carry out such and such a policy, such a directive would not be given unless there had been private disagreement earlier, and it would surely depend on how important the matter was and how great the degree of disagreement as to whether or not the government would want the Governor's resignation, or whether he should give it, would't it?

MR. CAMERON: I would think so.

COMMISSIONER GIBSON: We are interested, I think, in getting your ideas of when you get a sufficient degree of difference that the Governor should resign. If he has to resign whenever there is a slight disagreement, then he has very little independence. On the other hand, if he can stay in power regardless of the degree of disagreement perhaps he has too much independence. Could you enlighten us as to the area in between here?

MR. CAMERON: Well, suppose it was a disagreement on the question of the government borrowing a substantial sum of money from the Central Bank which could be treated in terms of printing money on a large scale: I would think a Governor who disagreed with this might be willing to make his disagreement privately known to the government, because he has got too much money or too little money, and perhaps stay in office and reluctantly go along with the directive up to a point, and then might be willing to say to the government, "I have done enough. I will go no further. You can fire me," or, "I resign", whichever you like.

On minor matters perhaps the Governor may be willing to go along against his better judgment but would ask for a directive to keep his own skirts clean if there were results which he did not deem sufficient to cause him to resign. Or, to put it another way, he might feel he was doing more good staying on the job and acting as a brake on the government and making a public issue about the matter than being replaced by a more pliant creature, but by requiring a directive by the government he would be fastening responsibility on them, to the benefit of posterity if a year from now the government wanted to blame the Bank for the results of its policy.

COMMISSIONER GIBSON: And looking at it from the side of the government, suppose there were some disagreements, some directives about matters which were perhaps not of major importance, or perhaps not of major degree -- there could be a difference in degree as to the amount of expansion that ought to occur -- and suppose the government did issue a few directives of this kind, and in this way the Governor of the Central Bank made his position clear in public, when would the government be able to ask him to submit his resignation? They might not like this process of issuing one directive after another.

MR. CAMERON: I didn't quite get the question.

COMMISSIONER GIBSON: I am getting back to what is the position of the government if they are not happy with the conduct of the Governor of the Central Bank, and there are a number of smaller incidents rather than major ones on which directives are issued, and you say they should have the power to

replace the Governor under what circumstances -- or ask for his resignation?

MR. CAMERON: If they had lost confidence in him.

COMMISSIONER GIBSON: And it is just enough to state they have lost confidence in him?

MR. CAMERON: I think there is a lot of master and servant that still presumably -- perhaps the common law.

COMMISSIONER MACKINTOSH: You are suggesting a very radical change. As far as I can recollect, nearly all heads of central banks have a fixed term. Now, there are circumstances in which he may resign or be removed, but some emphasis in the past has been placed on this assurance of a fixed term. To reduce a Governor of the Central Bank to holding office during pleasure is a pretty radical step, and I would think probably obviates the need for any directives, whereas if you provide for directives you can probably leave the fixed term, subject, of course, to removal for gross misconduct. What would you think of that?

MR. CAMERON: Possibly that might be a better way, sir. In the United States I think on two occasions the President of the Federal Reserve Board -- his term as Chairman had not expired and he submitted his resignation to the incoming President and was promptly reappointed. Whether he knew that beforehand or not is another question. There is a discussion extant at the moment making the term of the Chairman of the Board of Governors co-terminable with that of the President.

COMMISSIONER MACKINTOSH: That is another point not raised in your brief, but something that was raised in another submission: Do you think that would be a good system -- the term of the Governor's appointment should be like that?

MR. CAMERON: I would hope not.

COMMISSIONER MACKINTOSH: Would you feel that would undermine the independence of the Bank if he changed with a change in government?

MR. CAMERON: I think it would reduce it to a complete political pawn.

COMMISSIONER MACKINTOSH: Without going into them in detail, your general bias is toward fixing specifically in legislation the rules under which the Bank may operate. That is simplifying it, briefly?

MR. CAMERON: Yes.

COMMISSIONER MACKINTOSH: I have been bothered about this. Many things in the Federal Reserve Act are made specific, partly for historical reasons and partly because the Federal Reserve is a creature of Congress and the Treasury is a creature of the President, and this sets up a line of tension which requires more detail. Is there any danger of losing the advantage which we have on occasion in this country, because we are a relatively small country, of leaving some degree of flexibility and room for agreement. Do you mean in the case of, say, the cash ratio and liquid ratio, to reduce these fixed rates or leave the bank with a range in which it can operate?

MR. CAMERON: I think, if the cash ratio is

stated in the Act and there is procedure for changing it -- a certain range. As to liquidity ratios, banks always did maintain at some level, which I presume was dictated by their own prudence as bankers, and perhaps to some degree by the actions of their competitors. I think if the Governor had a mechanism specified in the Act to set a ratio, a varying ratio, that this would be an improvement over the system under which you might get the bankers in a closed room and say, in effect, "You fellows will do as I say or I will raise your cash ratios on you." The effect of the rise in cash ratios, say to a level of 8 per cent, would be a very severe squeeze on the banks, and if a Governor ever did wish to do the thing it would be, in my judgment a form of blackmail. I think it is better than it be in the Act.

COMMISSIONER MACKINTOSH: What you mean is, you want power in a statute to fix this sort of ratio if it is desirable to fix it?

MR. CAMERON: It is much better to have a set of ground rules that everybody understands than have them change when the Governor or the government thinks they ought to be changed.

COMMISSIONER BROWN: A lot of this has been in the field of experimentation, in the field of monetary policy.

MR. CAMERON: I think that is correct.

COMMISSIONER BROWN: What would you think of some sort of legislation so that if something was done in this way that was not specifically spelled out, that it was effective only for a certain period of time,

and then there had to be legislation backing it up? Because otherwise isn't the tendency to lose the flexibility we have for certain experimentation?

MR. CAMERON: I think your suggestion that innovations be tried for a short period and then enacted into legislation has much to be said in its favour except for one thing, that it may result in the Bank Act getting reopened every year, and since the banks' charters, I believe, lapse under the Bank Act, you have the banks in a situation of not knowing where they stood between now and the next session of Parliament -- at least, they would know no further than that. And since the Bank Act is decennial you could not say very well that this innovation should only last until the next division on the Bank Act. It may be nine years.

COMMISSIONER BROWN: I think this could be done within certain clauses of the Bank Act. In other words, the whole Bank Act would not necessarily come into it. I think there are ways of getting around it if the idea were cogent, because the same arises under the present system, that unless you have room for flexibility you develop certain rigidities that are locked in for a ten-year period.

MR. CAMERON: I think on the subject of secondary reserve ratios they ought to be able to devise a range which the government could change on notice of one, two or three months to cover any exigencies, and if the range were found to be somewhat on the low side because of, shall we say, a sharp influx of foreign currency or outflow of foreign currency, such as we saw in 1950, that you may be

looking at a situation which would require a rise in cash reserve ratio, and between the two you could deal with almost anything that might turn up. I particularly would like to avoid some degree of flexibility where in an emergency it could be used at the discretion of the Governor, to change the banking system every year or every few months as they get some new idea they would like to try out.

COMMISSIONER BROWN: You would have to have agreement, would't you?

COMMISSIONER MacKEEN: If everything were fixed by statute, would't there be too great a degree of rigidity due to conditions that may arise from time to time where the Governor or the government directives may be required to exercise more discretion?

MR. CAMERON: I think the cash ratios that you presently have -- the Governor has the power to raise them on notice, and if the ratio was raised from 8 per cent to 9 per cent, this would require banks to deposit something in the order of another $150 million. With an 8 per cent reserve ratio the present reserve serves as a basis for twelve times as much in the way of total footage in the banking system. With a 9 per cent reserve ratio, bearing an extra $150 million, you would be shrinking the banking system by around 1.3 billion. And you have the right to go up to 12 per cent, which could put on all the credit squeeze that anybody would want.

COMMISSIONER LEMAN: Except that a requirement for a change in the percentage does not have to be necessarily sudden. The Bank could give a directive that the new cash ratio must be met within X months.

MR. CAMERON: Well, the actual rise can only be done on a certain period of notice.

COMMISSIONER LEMAN: I thought you were describing how violent the effect of, say, a percentage change could be on the system. I agree it would be very violent if it was done over too short a period.

MR. CAMERON: I was saying in reply to Mr. MacKeen that facilities existed for prior notice, to deal with the banking system in a way which would look after exigencies -- there is a rigidity, but it still has lots of room in it.

COMMISSIONER GIBSON: Take the situation, I think it was late in 1955, when there was a very acute increase of loans with some considerable fear of inflation. At that time it was not an increase in the cash reserve requirement, but there was an understanding with regard to bank loans -- an effort in an informal way to put a ceiling on them, and there was also an understanding through large loans for capital purposes -- I am not sure I have got the date just right, but you know the time I am talking about -- and these methods worked for the time being, as temporary measures, not too badly. There may have been better ways of doing it, but at the time and under the circumstances the Central Bank thought this was as good a way of coping with the situation as any, and the chartered banks went along with it. I would not suggest for a minute they were forced into going along with it. There was a real problem. Would you say that sort of thing should not have been done, and the Bank of Canada should just have relied on its legal power to increase

the cash reserve percentage?

MR. CAMERON: No, sir. I think the Central Bank should have the power.

COMMISSIONER GIBSON: But how do you outline a power to put ceilings on banks loans? This is a very extreme power, and this was an informal agreement. Would you want to put that kind of thing in legislation?

MR. CAMERON: I think the liquidy asset ratio variation would have had the same effect if it were embodied in the legislation.

COMMISSIONER GIBSON: That came a bit later, yes. That was also one of these informal agreements in much less of an emergency situation.

COMMISSIONER MACKINTOSH: This reflects on the point I was raising: It seems to me you have to have many specific rules if you are dealing with something like 1100 banks in the United States, and there ought to be a smoother way of dealing with it when you are dealing with a very few banks in Canada; that you do not need as many -- I don't disagree with the contention that there should be statutory authority for this, but it seems to me if you are dealing with only a few banks -- and I forget how many there are at present -- there should be methods of agreement and common acceptance of ideas which really works better than highly specific statutory direction as against mere authorizing action.

COMMISSIONER BROWN: To carry on that, it could be said that if you did authorize it by statute you would have to, by statute, give the Central Bank more authority than it has now.

MR. CAMERON: I think perhaps its authority

has been rather limited, sir, if it chose to exercise it by suasion. If you get the banks to agree to a number of things which Parliament might not wish to embody in legislation.---

COMMISSIONER BROWN: The banks have the choice of saying no, and by that means it becomes a matter of public debate. The banks are in a position of forcing a public debate on it if they had so wished.

MR. CAMERON: Maybe it is not a subject that the public would understand very well, and I would rather see Parliament confer power on the Bank of Canada than have the Governor exercise power by the threat expressly implied that he might use other powers he did have conferred on him legally if the banks or anybody else did not come into line.

COMMISSIONER GIBSON: It is this question of suasion: Are you against it altogether?

MR. CAMERON: I think the Central Bank is a very powerful institution, sir, and its exercise of suasion is therefore a very powerful force. I think it is rather dangerous to leave it in the discretion of one man.

COMMISSIONER GIBSON: Would you like to narrow that discretion by being more specific about what the powers of the Central Bank are in the light of circumstances from time to time.

MR. CAMERON: That is correct.

COMMISSIONER GIBSON: Would you rule out the use of suasion in what appeared to be an emergency or a very unusual situation?

MR. CAMERON: I don't suppose you can rule it out entirely, and if the situation were an

emergency obvious to everyone ---

COMMISSIONER GIBSON: But this is seldom the case except in a war. Would you sgree the kind of situation we had in late 1955 was an emergency situation from a monetary credit point of view?

MR. CAMERON: It was threatening to generate inflationary pressures, and I think some of us rather expected there may be a rise in cash reserve ratios.

COMMISSIONER GIBSON: The sense of what you say seems to me to suggest that you won't quite say that the Central Bank should not use its powers of persuasion from time to time. On the other hand, you like to have it regularized as early as possible, and they should not use some form of persuasion as a regular instrument of monetary policy year after year; is this a fair statement?

MR. CAMERON: I don't think they should be in a position to bring new directives or ideas on the banking system unless Parliament has specifically given them the power. For instance, I believe the Bank at one time took a dislike to loans made to finance companies and requested that a ceiling be put on them. I am not trying to hold any brief for the finance companies, but it may be someone else tomorrow -- some other segment of industry -- and I don't think it is too good that one individual should be allowed to single out any specific area of the economy unless Parliament has given them the power.

COMMISSIONER GIBSON: In other words, a lot hinges on what you would regard as an emergency situation?

MR. CAMERON: That is correct.

COMMISSIONER MACKINTOSH: Are you not underestimating a little the power of the chartered banks, not exactly shrinking?

MR. CAMERON: Well, I think they have a certain amount of power, but their charters run until the next decennial revision.

COMMISSIONER BROWN: You make two recommendations, one with respect to the bank being directed to replace bills or run them off at the weekly option, and you have another recommendation that the bank again be obliged to arbitrarily set the bank rate. Are those two tied up together at all?

MR. CAMERON: Yes, they are in a certain way. That is my understanding, that the Bank of Canada makes two bids, treasury bill option, one for bills which they want for portfolio, and another one as a sort of reserve bid in case the market did not cover the tender.

The bank, if it wanted to, could bid a ridiculously high price, ridiculously low yield for the bills if it wanted, if it wished to influence the average tender rate and hence bank rate under the current rules. If we did fix the bank rate, of course, this would not matter to the same degree.

In the United States the Federal Reserve Board is allowed to replace bills which it has in portfolio and which are falling due, by buying bills at the option. It is also allowed to run them

off, but it is not permitted to increase its holding of bills over and above those which it is replacing, without going into the open market to do so. That particular aspect is rather a technical one and does not exactly tie into the bank rate, except if you have bids both high and low, bid unduly high in price to regular bank rates.

COMMISSIONER MACKINTOSH: I am not sure of my ground here. Is it not the fact that both in the United Kingdom and the United States the complement of this system is an informal arrangement that the market will take up the bills?

MR. CAMERON: That is the case in the United States, I believe, sir, and in the United Kingdom, that the market collectively --

COMMISSIONER MACKINTOSH: Has this not grown up because, if I remember, Treasury bills only appeared about 1932 or thereabouts, and there has been a continual building up of the markets. Is it not a question whether the market is now sufficiently broad and deep that you can get away from this direct intervention of the Bank of Canada? I just don't know.

MR. CAMERON: I think there was one occasion in August 1959 when it is possible that there were not enough bids to cover the tender. It is also possible that on that occasion the Bank of Canada did not even have the reserve bid to cover the annual bills because the Minister saw fit to withdraw part of the offering, and he did not say

the tender was not covered but he allowed that the low bids in price and high bids in yield were ridiculous - in other words, that the Bank of Canada, if it did have a reserve bid, was also guilty of putting in a ridiculous bid, which leads to the conclusion that perhaps on this occasion they did not have a reserve bid.

Under those circumstances perhaps the market is not big enough to be sure at all times there is a bid to cover the tender, but in most situations I think it is.

COMMISSIONER BROWN: What is the difference between exercising some influence on the one side of the market by letting bills run off and replacing and buying additional bills on the other side of the market? Why would you be in favour of the bank being able to influence it on the one side but not on the other?

MR. CAMERON: Well, I believe that the more the bank shows its hand in the market the better. It obviously cannot run bills off publicly until the next bank statement but certainly its subscriptions over and above those which are going to refundings can be revealed to the market place and a clue of the bank's policy of the moment.

COMMISSIONER BROWN: Would the same result be achieved if there was public disclosure of how the bank finished up on the bill option, instead of waiting for the following Wednesday?

MR. CAMERON: Yes, I think it could. This

is a matter we are in ignorance of until the following Wednesday and then there may have been enough extraneous transactions, but you are never quite sure.

COMMISSIONER BROWN: The thing I am also trying to get at is, unless an arbitrary bank rate is set, is there an assumption that the Bank of Canada is influencing the bank rates each week, and if this is so is this a desirable thing, or should they be doing this in the absence of a declared bank rate?

MR. CAMERON: I think there is a great deal to be said for setting the bank rate openly as a symbol of the central ~~ban~~ banking intent, but doing it through the back door is a less honest way of doing it, and you can never be sure because it is so easy for miscalculations to enter into even the bank's "fiddling" with it by way of the tender and by way of loosening or tightening the chartered banks especially if you have misjudgments on their part as to the effect of these other actions.

I think by indirection they can only take a stab at pushing the bill tender one way or the other. I would rather see it done in an open fashion, return to the old system.

COMMISSIONER MACKINTOSH: That is, you make the bill market conform to the bank rate, if not the bank rate conform to the bill market.

MR. CAMERON: I think the bill market would fluctuate in relation to bank rates, whether

of its own volition or in part through central banking interference. It would probably be something that varies from week to week. I think under these circumstances there would be more of a disposition to blame the markets than to blame the bank for the level of bill tender, and we would not always be looking at things like the cyclical repetition of the 3.06 high as being meaningful bank policy.

COMMISSIONER GIBSON: Do you think the market would regard the Bank of Canada as being more directly informed under the present system than they would so regard them if we had a fixed bank rate?

MR. CAMERON: Yes, I think at the moment they are regarded as being more involved in influencing the average rates than under a fixed bank rate.

COMMISSIONER GIBSON: This is a very important part of their business, whether they have a fixed bank rate or not. You agree with that?

MR. CAMERON: That is correct.

COMMISSIONER GIBSON: So they are always in this market. I just wondered why there is so very much difference in this particular thing through circumstances.

MR. CAMERON: Well, it is possible to influence the average rate by paying more for your bills than you have to. I am not saying this is

done, but it could be done, may have been done.

COMMISSIONER GIBSON: Having a fixed bank rate would not take the Bank of Canada out of the bill market?

MR. CAMERON: No.

COMMISSIONER GIBSON: They would still be free to borrow as they saw fit.

MR. CAMERON: One would then presume that they would try to get their bills as cheaply as possible.

COMMISSIONER GIBSON: What about the objections to the fixed bank rates, that there are times when, let us say, interest rates rise rapidly and the central bank has to prolong this trend - maybe an international trend, strong trend, and we have seen this happen a couple of times in Canada, one very strongly - if they just keep raising their set bank rate, this may add an impression that they agree with this kind of thing, that the thing has got beyond them and they are just being dragged along.

I think it is true to say that it was a situation of this kind that led to the floating bank rate, and one can understand the rather embarrassing position in which the central bank found itself at that time.

What weight do you give this in your thinking about this, when you say we should have a fixed rate?

MR. CAMERON: This is a small country and

it is subject to international capital flows. I presume our bank rate under the present system can get dragged along with others willy-nilly anyway. If we had a fixed bank rate and we had to adjust it because of these international complications, I have no doubt that each change would be accompanied by a statement that notwithstanding the view of the Bank of Canada it was necessary to go along with the trend in other markets.

COMMISSIONER GIBSON: Maybe they wouldn't want to say that?

MR. CAMERON: I think we are getting closer to the point where we must admit international forces to a degree we have not been willing most of the years since the war.

THE CHAIRMAN: We will now adjourn to two o'clock.

--- Adjournment.

--- On resuming at 2.30 P.M.

COMMISSIONER MACKINTOSH: The hearing will resume. The Chairman is delayed a short time: He will be in later but I think we might continue with the discussion.

I have some matters I would like to raise on the section of the brief entitled "Conflicts of Interest". Have other Commissioners points they would like to take up on matters ahead of that -- the money market or the Governor's report?

COMMISSIONER GIBSON: Mr. Chairman, I would like to pursue the question of bank rate a little farther if that is appropriate.

COMMISSIONER MACKINTOSH: Surely.

COMMISSIONER GIBSON: Mr. Cameron, would you mind giving us a little more of your ideas as to why we should have a fixed bank rate, that is, a bank rate for which the Central Bank takes responsibility? You, in your brief and in your comments this morning, made it clear that you were not very happy about the floating bank rate. Would you say a little more about the possible advantages of a bank rate which the Central Bank fixes itself?

MR. CAMERON: I think basically it is the one official signal which the Central Bank can give as to its view of the economy and as to the proper trend in money rates. The effect is probably more psychological than otherwise. I was particularly struck in reading the English Radcliffe Report by the fact that a number of witnesses said that the cost of the money did not make too much difference in the capital investment programmes of borrowers but that the sudden shock of raising the bank rate

from 5 to 7 per cent was extremely efficacious. From the explanations given as to why the cost of money per se was not important but a rise of bank rate was the effect, I think, is mainly psychological and is a signal.

In the United States where you have half a dozen members of the Federal Reserve Board either making speeches from time to time or appearing before congressional hearings they have an opportunity of augmenting their discount rate by what has been referred to as an open mouth of jawbone policy. This has not been the custom here and in Great Britain there is, I believe, less tendency on the part of the Governor or members of the Court to make public speeches.

COMMISSIONER GIBSON: The bank rate as a signal is a little less important if you have an open mouth policy?

MR. CAMERON: Well, I think the Americans reinforce their discount rate with an open mouth policy. The Bank of England spokesmen do not say very much very often and in Canada we have not been in the habit of listening to frequent speeches ---

COMMISSIONER MACKINTOSH: We had some examples.

MR. CAMERON: Unfortunately they did not all concern monetary policy.

On the subject of monetary policy we hear nothing from the directors which would be a counterpart of the American board members. So that I think bank rate here, as in England, and unlike the United

States is more important.

COMMISSIONER GIBSON: The occasion when such a signal or a signal of the kind of which you speak would be efficacious I take it would be extremely rare; this does not necessarily happen often?

MR. CAMERON: I can recall during the latter years of the war having coffee with a gentleman who was closely connected with the Bank of Canada at that time and the bank rate was lowered. He took it very seriously as an indication of the late war --

COMMISSIONER GIBSON: That was 1944, wasn't it?

MR. CAMERON: I could have been 1944 --- an indication of late war and early postwar monetary policy. This I never forgot and when bank rate was raised in the fall of 1950 I deemed that to be very important even though various people assured me that it really was not because the banks never borrowed money from the Central Bank.

COMMISSIONER GIBSON: It was not changed in between in that long interval, was it?

MR. CAMERON: No, not to my recollection. I think the events of the next few months proved that that was a significant change in policy.

COMMISSIONER GIBSON: There are occasions of the kind we have discussed this morning where a bank rate just really has to follow the market up?

MR. CAMERON: Due to extraneous things, yes.

COMMISSIONER GIBSON: Do you think the advantage of fixing the rate as a signal of circumstances

merely outweighs the disadvantages of the odd period like the one in 1955?

MR. CAMERON: Very much so, yes.

COMMISSIONER BROWN: Would you care to discuss from that point of view the disdvantage that results from the modern concept of getting ahead of your neighbour? If you get a signal that interest rates are going to go up would't you go out and borrow as much as you could before the interest rates go up?

MR. CAMERON: I suppose you do, thereby reinforcing the fact that bank rates are supposed to state that more quickly.

COMMISSIONER BROWN: Is this an advantage over a monetary change? Is this not really more people getting credit which otherwise they would not get if they continued in the normal course? This is a case of ---

MR. CAMERON: It is a case of the race is to the fleetest.

COMMISSIONER BROWN: Now, when the bank is just following along behind, in that case the bank is not controlling, is it, it is notifying no one?

MR. CAMERON: The bank under those circumstances is responding to extraneous things. I think the floating exchange rate over the last few years has played a part in minimizing those extraneous pressures but I would expect, given some day where you have a fixed exchange rate, in which case those pressures would become manifest in greater degree or earlier and to the effect that we have insulated ourselves with the floating rate of exchange from these extraneous pressures over the last few years

we may have created other problems for ourselves. I do not think a country this size, dependent upon foreign capital to the extent that we are, can presume to escape the effect of interest rate trends in other countries except by doing things which will react on us adversely in other ways.

COMMISSIONER GIBSON: You say with a floating exchange rate we have a greater opportunity to have a more independent bank rate policy or a larger degree of bank rate policy?

MR. CAMERON: Yes.

COMMISSIONER GIBSON: If you had a fixed bank rate would our bank rate policy be much different possibly from the United States'?

MR. CAMERON: I do not think it would except to the extent that the authorities were able to fiddle with it and spot the forward rates of exchange.

COMMISSIONER MacKEEN: Mr. Cameron, to get back to the question of the quick asset ratio that we discussed this morning that was presumably a counter-inflationary move on the part of the Central Bank when it was introduced, the additional 7 per cent over the statutory 8 per cent, that was, as I recollect it, a suggestion, perhaps a strong suggestion to the chartered banks from the Central Bank but there was not any compulsion attached to it. In other words, the Central Bank wanted them to do this but they did not force them to do it. It was voluntary on the chartered banks' part. Am I right?

MR. CAMERON: I don't know, sir. There may have been an "or else", I don't know, sir.

COMMISSIONER MacKEEN: You mentioned again

that the Central Bank insisted that the ratio be carried up to the extreme percentages such as 90 per cent. How would it be possible for the Central Bank to force compliance with such a policy?

MR. CAMERON: They could always threaten to use the cash ratio.

COMMISSIONER MacKEEN: I am talking about cash ratios.

MR. CAMERON: Well, the cash ratio could be varied between 8 and 12 per cent and the cash ratio in a fractional reserve banking system multiplies the effect of a change in reserve ratio $1 at 8 per cent by about 12 times in its impact on the whole system. If they raised to 9, therefore a rise of $100 million in cash reserves can cause a shrinkage in the total bank assets of $1200 million at 8 per cent and if the Central Bank has the right to raise rates in stages from 8 per cent to 12 per cent they can shrink the banking system most unmercifully.

COMMISSIONER MacKEEN: The Central Bank has the power to raise that to 12?

MR. CAMERON: Yes sir, in stages.

COMMISSIONER GIBSON: They have no power to set liquidity ratios under the present Act.

MR. CAMERON: No, except in so far as they can hold out as an alternative the threat of using the cash reserve ratio.

COMMISSIONER GIBSON: Yes, but liquidity ratios are not even mentioned in the Act, as I recall it?

MR. CAMERON: They have no statutory basis.

COMMISSIONER MACKINTOSH: I was interested in this section, Mr. Cameron, where you discuss conflicts of interest and what you thought was the wrong position of the Bank of Canada acting as it were for itself on monetary policy and on the other hand as fiscal agent for the government and agents for various funds. As I see it, there is a basic conflict here in that fiscal policy must on occasion adjust itself to monetary policy and on other occasions monetary policy must adjust itself to the exigencies of fiscal policy.

I am uncertain whether these things can be separated really. They are both dealing with the same money market. I have a recollection in the Radcliffe Committee Report where at one stage they said that aside from the external problems the Bank of England's debt management function comprised all monetary policy, they had no scope for anything else. To what degree do you think that having the Department of Finance or some branch of it undertaking to carry on debt management while the Bank of Canada carried on monetary policy, to what degree could these things really be separated or would you have two sets of people acting, but only after they had consulted? It seems to me neither could act effectively without the knowledge of the other. I am just puzzled as to whether these things could be separated.

MR. CAMERON: I do not think they could be separated in the final analysis, sir.

COMMISSIONER MACKINTOSH: Is there any advantage in having two sets of agents?

MR. CAMERON: I think there is in that if you have one body such as the United States Treasury and another body such as the Federal Reserve Board respectively charged with debt management and monetary policy, if you go back to the years after the war the Federal Reserve Board was completely subordinated to the Treasury's desire to refinance its debt on a cheap money basis. It was transformed into a "involuntary engine of inflation" as someone put it. This was dissolved about 1953 and since then both bodies have threshed out their differences at a higher level before they agreed on a compromise policy which they thought satisfactorily served both ends in so far as achieving the possible was concerned.

Now, let us suppose that we might have had the reverse procedure in this country: If we had someone in the Finance Department and someone in the Central Bank said: "Never mind the fiscal policy, monetary policy is the be all and end all, we are going to run this thing from the monetary policy viewpoint", you would probably victimize the government's debt management policy and force the government into a position of building up a rather poor debt structure and the Central Bank would in effect be dictating the government's debt management.

COMMISSIONER MACKINTOSH: This is only if the Central Bank could persuade the Minister of Finance. They act on his insturctions as fiscal agent.

MR. CAMERON: Sometimes we may have central bank governors who are extraordinarily forceful or persuasive.

COMMISSIONER MACKINTOSH: I hope we would have.

MR. CAMERON: Perhaps even domineering. And we might have finance ministers who were, shall we say, uninitiated in matters of finance and who were on unfamiliar ground and perhaps didn't understand the advice they are getting from their own people in the department.

COMMISSIONER MACKINTOSH: I can follow your argument that the Minister of Finance should have advisors of acknowledged weight on fiscal policy. I am not sure this necessarily goes as far as separation of the agency of action.

MR. CAMERON: Well, the bank itself could still be the agent handling the new issues, but the determination of the character of the issues might well be determined by the joint views of some strong collection of advisors in the finance department and the views of the bank. It is my feeling that the views of the bank tended to dominate both areas in recent years, and that there was an unconscious flavouring of monetary policy when those views are expressed to the Finance Department, particularly to the Minister, who perhaps could not recognize it too well.

COMMISSIONER GIBSON: Are you saying the Bank of Canada may have tended to dominate the

Department of Finance in this respect, or that the Department of Finance didn't have much of a debt management policy?

MR. CAMERON: The finance department during Dr. Clark's regime -- I think it was very fortunate in having a man who was rather catholic in his interests and a man of great force and perhaps able to hold his own even with Mr. Towers if there was anything upon which they didn't fully agree. It has been my impression in recent years that the people in charge of debt management had a lot of other jobs to do at the same time; it wasn't a full time responsibility; they didn't have the research staff the Bank of Canada had, and it was quite natural that the views of the bank would tend to prevail in the absence of evidence that some other policy should be followed.

THE CHAIRMAN: The United States Treasury has a very large debt management department which does its own research. It carries on conversations with bankers and investment dealers and decides what it would like to do itself before they get around to checking with the Federal Reserve as to what the Fed. thinks ought to be done. In that way there is a compromise thrashed out on a more equal footing than exists in this country.

COMMISSIONER GIBSON: You think it is an unequal footing rather than just leaving it to a large extent to the central bank to do these things. My impression is that the Department of

Finance has not had what you would call a debt management department at all. They had a man who spent a very large part of his time on it who died about two or three years ago, and I don't think they have had a developed debt management department; am I correct in that?

MR. CAMERON: I think you are absolutely correct.

COMMISSIONER GIBSON: Maybe the problem is not so much the Bank of Canada foisted their views or authority as them not having an active and continuous view; is that a fair statement?

MR. CAMERON: I think it is fair to say they may have moved into banking to begin with and perhaps afterwards found it was easier to let things go on this way.

COMMISSIONER BROWN: Has this arisen in part because of the conflict between the Bank of Canada and the department, and has it been resolved because of a clearer laid down responsibility -- in other words, is it clear the Bank of Canada is carrying out the policies of the government both in the monetary field and debt management?

MR. CAMERON: Yes, the government should have a clear view in the finance department as to what debt management policy would be the best from the standpoint as a borrower.

COMMISSIONER BROWN: It seems to me these all have to be melded together.

MR. CAMERON: They do eventually.

COMMISSIONER BROWN: The monetary policy and debt management, to produce the end result?

MR. CAMERON: They do eventually.

COMMISSIONER GIBSON: The classic example of trouble in this area is where the treasury is always over-ruling the central bank. In this case you are complaining about the other thing, and usually one expects a central bank to have a somewhat longer view and, therefore, perhaps a somewhat better view from the broad national point of view on these matters, because they are not subject to the ordinary pressures?

MR. CAMERON: I would like to cite the conversion loan as an example, particularly since events in recent months indicate that the government has reversed its view of 1958 that the debt had to be extended, and it has been engaged in buying in and cancelling the long term debt. If the conversion loan is a creature of the bank, I think a proper debt management division in the finance department might warn the Minister more strongly as to the long term effects of it. If the loan is the creature of the finance department, the bank obviously did not warn them very strongly that within four years they would be trying to shorten their debt by paying in long funds, with money borrowed on the short end of the market. So, I am led to the belief this was the bank's creature and that the department, with such a debt management commission as I have in mind, might

have rejected this idea and only bought it in modified form.

COMMISSIONER GIBSON: You say a great deal -- not a great deal, but quite a bit about the conversion loan in your brief: Is it your view that the conversion operation at that time was a bad thing, or is your objection basically to the way this has happened?

MR. CAMERON: I think the concept of it had something in its favour, but I think it was pursued too far, and badly handled.

COMMISSIONER MACKINTOSH: When you say it was pursued too far, you mean it was too large a scheme?

MR. CAMERON: It was too large and too comprehensive a scheme.

COMMISSIONER MACKINTOSH: It was too big a bite?

MR. CAMERON: And I think it may have gone too far in the direction of dealing with issues that were eight years removed from maturity. I have a reference in here to statements to the effect that the market regarded these bonds as due on their call dates, principally the 1963 and 1966 maturities, which were callable in 1961. This is a rather ridiculous statement when you consider that the 1966 maturity was selling at over five points discount.

COMMISSIONER BROWN: You mentioned disagreement: Are you under the impression it might

have worked more smoothly if the market had moved up and exchanges had taken place at current quotations?

MR. CAMERON: I think that would have been a much more honest way of doing it -- saying, "Here is a new bond. You can have it in trade for your 1966 if you like, or, if you don't like, you can keep your old bond. We are not putting any cash price either on the new bond or on the old one and we will let the market determine whether the rights value attached to this exchange will be placed on the value of the old bond or what the market is willing to pay for the new bond." You will recall that the old bond was selling at about 94 and a half the day before the loan was announced, and it was worth par the next day; not through any active market, but because the marketing committee and the bank decided that was the appropriate value.

COMMISSIONER MACKINTOSH: Had they not acted, would not the market have lifted that bond to par?

MR. CAMERON: I would doubt it. I think your equilibrium point might be some place between the old value of 94 and a half and par. That is a matter of opinion. The fact remains they had to buy back a lot of their own merchandise at the prices they put, to wit, par, on the longer Victory bond in 1966, indicating that there was a body of individuals who preferred cash

to the new bond at that price. I don't know what the price would have been, but it would have been a free market price.

COMMISSIONER MACKINTOSH: As I read financial history, all the respectable people seem to have been in favour of funding, though not many people have done that in recent years; but you think, within reasonable measure and properly handled to extend the term of the debt may be all right, is that it?

MR. CAMERON: Yes, I think so, as a matter of general principle, sir.

COMMISSIONER MACKINTOSH: Was there not some fortuitous circumstance -- I forget the details; the United States' rates moved rather sharply, did they not, before this operation was over?

MR. CAMERON: They had already started to move rather sharply before the operations commenced also. The United States market reached a high point, if I remember correctly, late in April 1958, and certain reasonably long term bonds had already moved off in the order of three or four points by the time the conversion loan was announced, and on top of that the banks, I think, were really tempting the lightning when they assumed in the face of an already obvious trend in the American market that they could freeze -- in effect, close up -- the free bond market of Canada for 60 days and expect that they would put

this operation across without any repercussions. I would suggest this is an error of judgment.

COMMISSIONER MACKINTOSH: It may have been originally that the Minister judged that the mark-up in rates that was inherent in the conversion would have allowed him sufficient freedom for monetary restraints, but that in the event he did not have any leeway --

MR. CAMERON: If he had forgotten cash price and merely announced a bond for bond exchange he need not have cared what happened in the American market or to our market. He was offering the bond at one and a half per cent more interest -- never mind the relative ---

COMMISSIONER MACKINTOSH: On the intervention of the Bank of Canada into the bond market in any of its various functions, my understanding is that it has always known whether the bank is acting as principal or agent.

MR. CAMERON: They generally will tell you if they do a deal that they are acting for an account, or, if they don't tell you they are acting on their own. This gets back into the question of the use of trust funds, perhaps, because if the bank has discretionary power over the use of extraneous accounts, it can pursue policies designed to affect the level of the market using, in effect, somebody else's money.

COMMISSIONER MACKINTOSH: You think they are not just carrying out operations necessary to

raise funds, but are using the funds for monetary purposes?

MR. CAMERON: Or for debt management purposes.

COMMISSIONER MACKINTOSH: Or for debt management purposes?

MR. CAMERON: Yes. I think the use of the Unemployment Insurance Fund in the summer of 1958 is a case in point.

COMMISSIONER MACKINTOSH: Well, of course, one of the difficulties earlier was in the fund holding long term bonds.

MR. CAMERON: It held a balance, I believe, in the order of $80 million or $90 million in 1959 and 1960 -- maturity as well as the bonds -- and during the conversion loan these were exchanged for conversion bonds even though an examination of the seasonal pattern of the fund, even in a normal year, let alone the year in which there was still substantial unemployment, this pattern would show that the fund would have to liquidate some securities by fall, and yet the fund was permitted to denude itself of its most liquid assets. As I recall it, it had hardly any treasury bills at that time. Also its 1959 and 1960 maturities were its most liquid assets -- the two next due Victory Bonds.

COMMISSIONER LEMAN: Mr. Cameron, we had a witness a few days ago who put in a whole brief to prove to us the conversion loan had an

effect of raising Canadian interest rates -- the whole pattern of Canadian interest rates quite a bit above the normal pattern of difference with the United States rate; do you think it had that effect?

MR. CAMERON: I think basically it did have that effect.

COMMISSIONER LEMAN: Do you think in that sense perhaps it was part of monetary policy?

MR. CAMERON: I am sure the whole thing, if you regard it as a conception of banking rather than the financing part of it, was monetary policy pure and simple, and that debt management was sort of dragged in like the cat as the excuse.

I believe it had dawned on certain people in the month of June that the recession was over, and that a lot of money had been pumped into the system, and that we were facing a record deficit which would cause the creation of a great deal more money in all probability, and that such a deficit may not have been appropriate with a recovery and some means ought to be found to offset that deficit.

One way you could do it was to have a tight money policy, but the difficulty in having a tight money policy, if you have a lot of liquid assets in the hands of the public, is that they can cash them in at maturity, if they are short-term assets sell them at minimal losses. Therefore it would be a good idea if we could find an excuse to cause the public to surrender these short-dated assets for longer-dated securities, so that when we get our tight money policy they will sell at substantial losses and many people would have occasion to liquidate, and that the loan essentially was a scheme to take away the 1959 and 1960 and possibly the 1962 maturities which were to some degree still held by the original purchase , and to make the thing jell is a Victory Loan conversion scheme, and '63 and '66 down were added as an after-thought.

COMMISSIONER LEMAN: Mr. Chairman, in your brief you make the point quite a few times that if the Bank of Canada in exercising these powers for monetary policy ojectively, would stick to the short-term instruments, that arbitrage would take care of the differences to establish the appropriate rate curve from shorts to longs. Do you think that

arbitrage actually does adjust properly? I think you have just explained to us that influence in long-term areas can be quite a weaponfor monetary policy.

MR. CAMERON: I would hope it is never used in that manner again, because I think it has been responsible for causing the atrophied position of the monetary market most of the time since, and at the same time creating, for lack of a better word, I will call it a "shock" to government credit and produce a higher level of interest rates than would otherwise have been pursued.

COMMISSIONER LEMAN: I think we are trying to distinguish here between the objective and the way it was done. Let us not get back again into certain mistakes that have been made and the way it was handled and all the accessory things that you object to, but as an objective, if the monetary authority all of a sudden finds that the rate curve has gone wrong, why would it not take interest in trying to rectify it?

MR. CAMERON: Because I do not believe there is any man alive who has the second sight or perspicacity to decide what is a proper yield curve throughout the whole spectrum of instruments.

COMMISSIONER LEMAN: Well, perhaps not in the absolute, but certainly we talk about perverse ways in which a certain kind of action reacts sometimes and you do meet in their connection to an interest rate curve in the U.S.A., for instance, and that of Canada. Surely without being too absolute about it, you can determine if you have got a rate

curve that is wrong, can't you?

MR. CAMERON: Well, with the free access to our market which the funds have, plus the substitutability of one asset for another that our institutions have, I would think that this thing would iron itself out with the passage of time, at least as well as any person, to form a judgment that this, that or the other relationship was wrong, because you would have the decision made by a thousand investors that it was wrong, and that would be something about it for the condition that would prevail, and would reflect the judgment of the market at large.

COMMISSIONER GIBSON: Carrying this argument a little further this is really the "bills only" argument or the short-term end only for a smooth, bank, open market operation, apart from the question of the rate term, whether or not anybody can have a sensible view of what it ought to be at a given time, and at any given time the government has so much weekly assets coming up.

Now, recently there has been a lot coming up, and here you run into the question of debt management and monetary policy, and they are so closely interwoven that, as Dr. Mackintosh was suggesting earlier, it seems awfully difficult to view it as anything but one inter-related set of problems.

Can you in fact take the position, in view of the maturities coming up one after the other, that a Central Bank should confine itself to bills only or very short-term Governments in its open

market operations.

MR. CAMERON: I think they would have a much better market if they restricted their own activities to bills and, shall we say, money market securities, in other words maturities under three years.

COMMISSIONER GIBSON: Up to three years.

MR. CAMERON: This is the area in which the market is broadest and in which they can effect the necessary adjustments in a chartered bank cash reserves with the minimum impact on price.

There are two reasons for this. One is that the market is broad and the other is the mathematical one, that a change in yield has a most minimal effect on capital values the shorter the term of the instrument.

COMMISSIONER GIBSON: This has not been the Canadian practice, nor has it been the British practice, as I understand it. It is closer to being American.

MR. CAMERON: And the Dutch practice.

COMMISSIONER GIBSON: Why should the Central Bank draw off the right to intervene in the medium and longer term? This might be a good reason for it.

MR. CAMERON: I think their intervention has done a good deal over the years to cause the market to be regarded as a good place to stay away from, because they are likely to intervene in one side or the other, and the more they intervene the more they produce the fictitious level of prices -- fictitious in the sense that they themselves have been the greatest force contributing, with a secondary following of people looking for capital gains.

I wlll go along and "play with the house", if I can put it that way, and then when the bank reverses itself, steps out of the market, the secondary following deserts the market also. They can fool themselves as to the level of the market of which they are the principal creator.

COMMISSIONER GIBSON: You are arguing that the net effect of this is a higher long-term structure of interest than they otherwise meant to have.

MR. CAMERON: In a market which does not provide a proper indication to the government as to where it can raise money. If we wanted to reduce it to mining stock terms, if the promoter has made a market in a mining stock both sides of the market and he has produced a situation where only the most gullible would assume that that level would prevail once the promoter stepped out of the market.

COMMISSIONER GIBSON: I don't know whether this is an altogether appropriate analogy.

MR. CAMERON: I am trying to paint a broad brush.

COMMISSIONER GIBSON: Suppose the Central Bank went to a short-term Canada instruments only policy, do you think that the medium and longer term market would develop in a smooth kind of way, or would you have a period when prices were pretty erratic.

MR. CAMERON: Speaking personally as a jobber, I think our activities in the market would expand. We would be more willing to take positions based on our judgment as to what was value, long or short, knowing that the other forces in the market

consisted of other dealers, institutions and the chartered banks who were operating and forming judgments on the basis of roughly the same facts that we can see. I think the market would broaden.

In the early 1930's there was no Central Bank, and although you had a market that had wider spreads between bid and asked, it was possible to trade blocks of a quarter or half a million dollars worth of long-term Governments without a Central Bank. In terms of today's debt , this would be the equivalent of talking of bundles around five to six times as large.

COMMISSIONER GIBSON: That is what I am wondering -- some of the big bundles that would be tossed out on the market, and Central Bank pay no attention, that you might not get some quite substantial variations in price, however erratic, not necessarily meaningful in character.

I think you would find more institutions willing to arbitrage if a bundle of bonds was thrown on the market at an unduly cheap price; there would be a number of people willing to work them off in exchange for some other Government which they thought was now slightly high priced by comparison, so that the impact of that one bundle would be diffused throughout the range of other long-term bonds, or you might encourage people to liquidate shorter issues and buy them.

COMMISSIONER GIBSON: One other question on this "pool bills only" approach. Suppose, to maintain investment boom in the economy of the kind we had from 1954 to 1957, early 1957, in those

circumstances -- and certainly with the benefit of hind-sight one can see that the rise in the long-term rate of interest was a desirable phenomenon from the standpoint of cyclical economic policy, if you stick to "bills only" this has got to gradually work its way through. If you can buy and sell longer bonds, Central Bank is in the position directly of endeavouring to change longer-term rate of interst, and in some circumstances I suggest this might be the right kind of policy.

MR. CAMERON: In one of those years the Governor is on record ---

COMMISSIONER GIBSON: I am not talking about what the bank can do.

MR. CAMERON: --- as saying that the rates would have risen further had they not intervened.

COMMISSIONER GIBSON: I realize that there was a certain difference of view at this time, but what I am asking is , would there be merit in the policy which was designed to raise long-term interest rates in those years rather than to lessen the rise.

MR. CAMERON: I think there would have been, but the bank chose otherwise.

COMMISSIONER GIBSON: That is right.

MR. CAMERON: To minimize the rise in rates, and furthermore I think it was the spring of 1956 or 1957 when at a time of general restraint they told the banks that they could lend an extra $200 million, I think the amount of money was, mortgages and that the bank would furnish the necessary reserves.

COMMISSIONER GIBSON: I think that mortgage problem is in 1955, and the really tight situation

in 1955, and the really tight situation came in 1956, did it not?

MR. CAMERON: I think it was the spring of 1956.

COMMISSIONER GIBSON: Late 1956, early 1957. Well, would you admit there were circumstances in which it might be desirable for the Central Bank to work directly on the long-term rate of interest? This is my basic question.

MR. CAMERON: I am afraid I do not, sir, after seeing them operating in the long-term rate of interest over the last few years.

COMMISSIONER MACKINTOSH: Mr. Cameron, this is getting down very close to saying that they are such inept operators that the fewer places they operate in the better. It is not very helpful as a guide to policy.

MR. CAMERON: Well, if you are the largest bull in the china shop, the smaller the area of the shop you are confined in the better. I believe the concept of many central banks is that their prime function is to bury the reserves in the banking system and let the chips fall where they may in the interest rate structure.

COMMISSIONER MACKINTOSH: As a supplementary question, does the United States Treasury operate in the bond market?

MR. CAMERON: They invest money for trust funds in the bond market.

COMMISSIONER MACKINTOSH: They do not operate --

MR. CAMERON: On one occasion after a disorderly market in May of 1958 in which speculators

bought a large amount of an issue that subsequently went to a discount, the Treasury did buy in a portion of the issue and cancel it. The Federal Reserve since the spring of 1951 had been operating beyond the short range, although, as you can see from the testimony of Mr. Martin later in my brief, he is beginning to wonder if he had not over-done it.

COMMISSIONER GIBSON: Did I understand you to suggest that during the years 1954-1957 that if the Bank of Canada had not intervened at all in the long-term market, the natural forces would likely have resulted in raising the interest rate?

MR. CAMERON: Yes sir. I forget the exact words of the Governor's report, but it was to the effect that the rise in the long-term interest rate which had taken place would probably have gone much further left to its own devices. I believe Mr. Hampson recalls the year. 1956.

COMMISSIONER GIBSON: I have a very general question I would like to raise with you, Mr. Cameron. Throughout your entire presentation there is a general atmosphere to the effect that you do not really trust the monetary authorities too much certainly not governments too much. Mr. Mackintosh was just referring to this. You imply - in fact you say quite directly that we are in a long term period of debasement of our currency in fact and that you are very concerned about this and this matter seems to direct a lot of your thinking or at least affect your thinking on a good many of these matters. Now, I would like to ask you if you can give a reasonably brief sort of answer, what you think the medium and longer term outlook from the standpoint of inflation is. In the process you could tell us whether or not you thought this was something that could be changed or if it is an underlying trend that seems rather deeply embedded. I would like to hear what you have to say about whether changes in the general economic environment are improving or making this problem worse?

MR. CAMERON: I have submitted, sir, some supplemental thoughts along this line which I would like to summarize if I may. Mr. Hampson has a copy and I have three or four more which could be passed around.

Basically, if you read economics history, currency debasement has gone on, I think, since

currency was invented. There was one exception to this general rule. From the first quarter of the last century until possibly the war of 1914 when currency tended overall to hold back prices fluctuated to perhaps not more than 30 per cent in any one direction and then tended to correct themselves and go back to where they had been.

At the same time, people who bought British government securities found there was a gradual raise in prices and it is in this area that the British Financial Institutions, as we know them today, started to grow and I think our system grew in the same image. Popularly, this is associated with the gold standard. England really did not have much gold and I think it was the stability of the pound sterling that made the gold standard work. Since then we have had two world wars which completely destroyed a number of currencies and partially destroyed others. We in North America have been most fortunate in that the destruction of the value of money since the start of the last war has not varied more than 50 per cent. But we now have governments spending a quarter or more of the gross national product and dedicated to the idea that they can maintain full employment by a counter-cyclical fiscal policy with monetary policy to aid and abet this.

So that the counter-cyclical deficit is easily excused because we are in a period of recession and rising unemployment. Nobody ever wants

to get around to a counter-cyclical surplus. It is just human nature.

COMMISSIONER MACKINTOSH: Well, there were quite a few years of surplus.

MR. CAMERON: I think those were rather inadvertent also in that they stemmed from rises in price.

COMMISSIONER MACKINTOSH: Deficits were inadvertent too.

MR. CAMERON: There is something rather imperfect in the financing of deficits by monetary expansion. In practice the government gets a lot of new money which has been created and spends it. As it gets into the hands of the public some of them spend it in areas where there is slack in the economy and it does some positive good in that it reactivates idle labour and capacity. Others try and spend it in areas where there is not any slack and this enables the people in that area to raise their prices and wages successfully. Some spend their new money on foreign goods because our goods are not competitive and this creates balance of payment problems. Some will buy goods that used to go for export and this also has its effect on the balance of payments.

We finally reach a point perhaps where to keep the economy going at the rate which we have attained we are going to need some more money added to the system to finance the areas where price and wages have risen. So we get people saying we need

more money supply because the economy is slack and then later on we need more money supply because the economy is operating at a higher level than before and if somebody puts the brakes on then the fellows who have priced themselves out of consumer markets start to have slack capacity and unemployment again.

I think that this situation has been with us since about 1946 in spasms and has the effect of causing prices to rise during a boom and stops them falling during a recession and acts as a sort of ratchet on the price structure. This is done in public consciousness and you have people altering their financial behaviours so that such money as they do save is finding other outlets to that which it did under the old assumption of stable money.

For instance, our life insurance companies and saving bank deposits have grown much more slowly than the gross national product. If you take the gross national product since 1946, last year, it ran to 306 per cent of the 1946 level but your savings deposits in banks was only 239 per cent of the 1946 level. Your 12 largest life companies were only 246 per cent in assets above the 1946 level. The largest company presents a rather complete financial statement which, among other things, shows that dividing the business in force into the premium income it reveals that the average premium has gone down from $42.70 to $23.41

which would indicate to me that people are not using life insurance for savings in the way they used to but rather are buying fire insurance on their lives and putting their money into mutual funds or things of that sort.

I think this is creating a strong diminution in our institutions which lend money and normal savings relative to the G.N.P. If we carry this on long enough and couple it with an increased willingness to borrow money on the part of people, municipalities and others because they hope to pay it back in cheaper dollars, we are going to fasten a high scale of interest rates on ourselves.

I am afraid this is a way of life. It is one of the weaknesses in democratic government which inadvertently adopts these policies in catering to the desires of the voters for "pie in the sky" or guaranteed full employment or whatever you want to call it.

COMMISSIONER LEMAN: Is there anything we can do about this?

MR. CAMERON: We can learn to live with it.

COMMISSIONER GIBSON: Don't we learn anything, though, from our experience? Look at what some of the European countries have done. They had a highly inflationary situation in most cases up until six or seven years ago. Most of these countries have taken their affairs in hand and

gotten them in reasonable shape. Great Britain has been through two tight money situations and now, in an effort to improve their basic economic affairs she is talking about taking a very long and difficult step and going into the European common market.

In the States you point to their policy in the last few years. They have shown some reasonable measure of restraint under considerable political pressure. I just cite these things to you to show that it is perhaps not quite hopeless.

MR. CAMERON: No, it is not hopeless and in the European countries either, their currencies go right down, not once but twice.

COMMISSIONER GIBSON: The British did not.

MR. CAMERON: In the case of the French franc we would be as well off with the 1870 French franc as the United States would be with Confederate money. They learned the hard way. The British did not quite have to learn the hard way because they would probably have been on the brink of starvation if their currency had gone any lower. I think the United States has now realized that it must put its internal housekeeping in order; otherwise, its reserve of gold may be drawn away from it and the dollar may have to be debased.

COMMISSIONER GIBSON: But they are facing the problem.

MR. CAMERON: I think they realize the

problem. I am not quite sure whether we in Canada have not been living in a bit of fool's paradise during the last 15 years. I won't use the phrase living beyond our means but maybe we need a shock.

COMMISSIONER BROWN: Would the pressures of a free exchange rate bring this about?

MR. CAMERON: The pressures of a free exchange rate unfortunately can be altered by monetary policy. I think perhaps the exchange rate has been the make-way for all the other things we wanted to do. For instance, in making money unduly tight several years ago we created situations which drove borrowers into the United States markets who brought back United States funds in even greater volume than we needed to cover our balance of payments deficit at whatever was the equilibrium level and the surplus United States funds drove the price of the American dollar down to the point where imports were attracted into this country which would not have come in at the higher rate for the United States dollar.

Now, we have reversed ourselves and we are going the other way. If we made money too easy in this country I am sure that our exchange reserves would disappear if we tried to hold the rate or that our dollar would to a most significant discount if we raised the rate and this would raise the cost of living. This would be a cut in real wages. This would probably restore our competitive

position except that those who save money would lose a good portion of the value of their savings if the prices went up.

Another way to get on the track is by cutting money wages but that is politically unpalatable and would visit great suffering on those who are heavily in debt.

I think the mills of the gods are grinding in the direction of teaching us a lesson but whether it be in the form of depleting exchange reserves or diminishing value for our dollar or a rise in domestic prices or a combination of all three at different times I don't know but I think if we continue to run deficits in the order of three-quarters of a million when we are supposed to have a seven per cent increase in G.N.P. this year that we are in for some trouble.

COMMISSIONER GIBSON: Looking ahead in the usual western world environment, the environment in which we live, what do you see -- gradual increase in the world price level, a relatively stable world price level or what?

MR. CAMERON: I think commodities might even get cheaper, sir.

COMMISSIONER GIBSON: You are not concerned about the world inflationary environment for the time being?

MR. CAMERON: Not particularly. I think that we are more prone to inflationary pressures here than perhaps the Americans and perhaps the

Europeans in general notwithstanding what is going on in Germany at the moment because I think they have shown in the past the will to correct things.

COMMISSIONER GIBSON: You would not go along with this idea that there is a permanent tendency for prices to go up two or three per cent per annum over a long period?

MR. CAMERON: Services perhaps and manufactured goods prices with higher labour content but we seem to be getting into an area of over-production of basic commodities which would tend to hold prices stable or bring them downwards and that is all the more reason for us to keep our own costs in line because we ourselves are producers of some of these basic commodities for the world markets.

THE CHAIRMAN: Have you any special views in relation to sales of securities regulations, whether or not it would be desirable to have a securities commission or an S.E.C. in Canada so that there would be uniform regulations throughout the country?

MR. CAMERON: Just rather general ones, sir. I do not deal in corporate securities but there are some things that I think are desiderata in this country and that they could be more easily attained under one set of laws instead of ten jurisdictions enforcing, what the Saskatchewan commissioner says is 25 different sets of laws.

In the past there have been cases of

unscrupulous operators who get ruled off the course in one province setting up shop somewhere else and doing damage before they could be brought to book. I would think that if there was a federal jurisdiction one false step and they would be through.

Another thing that appeals to me about what the Americans do is take steps to prevent directors and officers of companies from taking undue advantage of inside information purely by compelling them to publicize transactions in shares of the companies in which they are interested. Since stock exchanges operate under four different jurisdictions it might be better if there were one law governing them all so that no one in any one province would be any less subject to such requirements.

Another thing that the Americans have done with their S.E.C. regulations is compel the production of most voluminous prospectuses with a great deal more information than is the case in this country. I suppose some people do not read them but the information is there. I think that could be better done under one jurisdiction; otherwise, you would find people filing their prospectuses in the most easy-going manner to provide the minimum of information.

One other thing, I think stock exchanges have got to be a place where a buyer and seller meet on an even basis in a really free market. One of the rules in the United States was that stock

exchanges were not places to be used where distribution of treasury stock takes place because this sets up a situation where there is profit to be made in distributing treasury stock. It is true that the public ought to be able to tell from looking at the quotations that a company is distributing treasury stock but they do not. There again, if that were deemed desirable I think it would be better that there was one jurisdiction rather than some saying you can do it in one province and others saying you cannot in the next province.

I don't know whether this comes under the property and civil rights --

THE CHAIRMAN: There may be some question about that, but we are interested. We have had a number of witnesses before us who have discussed this problem and we thought perhaps you would have some useful views on it. It may be there are constitutional difficulties, but nevertheless it is a problem.

MR. CAMERON: There may be the trade and commerce definition.

THE CHAIRMAN: I don't know we need to figure out what it means or what would have to be used to accomplish the purpose; but the question as to whether it would be desirable is a question which, I think, is relevant to our inquiry.

MR. CAMERON: I think it would be basically desirable.

COMMISSIONER MACKINTOSH: The London Stock Exchange provides for primary distribution, doesn't it?

MR. CAMERON: I am not sure, sir.

THE CHAIRMAN: Is there much primary distribution on the Toronto Stock Exchange now?

MR. CAMERON: I believe there is in the field of mining and oil shares; additional options were granted to promoters.

COMMISSIONER LEMAN: I would like to ask one more general question: To what extent do you believe that monetary policy can be effective in Canada in our circumstances for the objectives that you, at least, seem to recognize in your brief? In a way you seem to suggest some amendments to the way the Bank of Canada should act which, to me,

indicate it may weaken a little bit their powers of control, and even with their present powers of control -- assuming, of course, the objective is not wrong in the mind of the Governor at the time he adopts the policy.

MR. CAMERON: Your question is basically, do I think monetary policy will work in Canada?

COMMISSIONER LEMAN: Yes.

MR. CAMERON: I think that monetary policy in Canada can only work to a rather limited degree should it be in conflict with the monetary policy of the United States. Commerce and money have a common propensity to find their own levels in that the American -- well, I think Mr. Towers' expression was, that a few splashes of water to the Americans could be a flood here. I think this works to this day also.

COMMISSIONER LEMAN: Would this argue for having more power of control in Canada; in other words, where you are more exposed you need more violent action?

MR. CAMERON: I think if we take any violent action to insulate ourselves against some particular happening in the United States that we will probably build up in some other area a counter-pressure as a result of our divergence from their policy. Let me put it this way: If our money rates diverge too far from those of the United States you begin to set up exchange flows, and if they attain a large magnitude you are going to have a change in the exchange rate and a change in the propensity to export or import. If you had a fixed exchange rate and a divergence of

interest rates and a wide degree between here and the United States, you would have the government in the position of having to run its exchange reserves down in maintaining the fixed rate, or being on the receiving end, as you were in 1950, of great gobs of money which the government would have to find the wherewithal to finance. I don't think there is any way you can get away from the influence of United States monetary policy to any material degree without setting up an embarrassing force in some other area.

COMMISSIONER LEMAN: You mean we have to trust they will adopt the right policies?

MR. CAMERON: I am afraid that we are not exactly the thirteenth federal reserve district, but we are imperfectly insulated from the other twelve.

THE CHAIRMAN: Our policy would necessarily have to be conditioned to their policy, and it may not necessarily be exactly the same.

MR. CAMERON: With minor differences.

THE CHAIRMAN: With minor variations: You see that as inevitable?

MR. CAMERON: Yes, sir. You have probably had people suggesting a regional monetary policy for Canada, and other people telling you this is not very practical, as between the Pacific Coast, the Maritimes and the Central provinces. Well, what I am suggesting is that a regional monetary policy for Canada alone is rather difficult when we have so many agencies, especially borrowers and lenders, having access to the United States market, and if we set up barriers in one direction we get these forces

in the other direction. If we fiddle with our interest rates we pay the price on the exchange rate, and if we fiddle with our exchange rates we may pay the price on the interest rates.

COMMISSIONER GIBSON: Mr. Towers once made the statement that to combat inflation in this country, it would be very difficult for us to do better than the Americans; we would have to work fairly hard to do as well, and we could easily do worse: Do you agree with that view?

MR. CAMERON: I would agree with that completely.

COMMISSIONER BROWN: In connection with the money market you suggested that the present restrictive money market could be changed and that the money market should be thrown open to all dealers who wish to participate on the basis of the margin requirements suitable for the particular piece of paper they wished to deal in: Would you like to expand on this a little as to what extent you think this might make the Bank of Canada's position a little more difficult or possibly easier?

MR. CAMERON: At the moment you have a restricted number of dealers enjoying the privilege of membership in the money market which includes, first of all, the privilege of borrowing against certain collateral at special day-to-day rates at the chartered banks, and in the event that supply of money dries up that they have recourse to the Bank of Canada bank rate. Other dealers against the same collateral may not enjoy the privilege of day-to-day loans from the chartered banks nor the accommodation

at the Bank of Canada. In return for thisprivilege dealers who are members of the official money market find the Bank of Canada displaying a fatherly interest in what their portfolio contains, which must be Canadas under three-year term -- including Treasury bills, and I suspect there are some members of the money market who make good money out of their dealings in these securities, and there may be others who stay in the game not because they are making any money out of it but because there is a certain prestige attached to it. If the thing were thrown open to everybody I think there may be some of these who are staying in for prestige reasons who might do a good deal less, and that the main volume of the market would probably get into the hands of four or five principal operators, such as the English Discount Market is in the hands of approximately a dozen, but that the other dealers enjoying equal privileges as and when they chose to exercise them would exert a discipline on the market as the outside houses do in England. If the English money market decide to gang up on the Bank of England and put in an unreasonably low bid for bills, the outside houses would probably get them, and I think that if the market became a market of four or five dealers here doing most of the business that the rest of us could come and go as we saw fit, and if we thought bills were going too cheaply we would be able to impose a discipline on those major houses, but that your market over-all would be broadened in the number of people who would participate in it. The bank would probably not have the same control over the members'

inventories.

COMMISSIONER BROWN: This would indicate that you assume the market would get into a narrower control at the expense of the Bank of Canada, really?

MR. CAMERON: I think there are people who are, to use the vernacular, engaged in shovelling smoke part of the time. If they are members of the money market, "we may not want to bid for bills this week but we feel we have to".

COMMISSIONER BROWN: And your idea was that this creates a false market?

MR. CAMERON: And this is a condition of the market you can well be without.

COMMISSIONER BROWN: It would be a truer market if it were free?

MR. CAMERON: And it would be much better if there were 40 people able to go into the bill market as and when they felt like it and not because it was expected of them.

COMMISSIONER BROWN: Where would you draw the line -- anybody on the Bank of Canada list could?

MR. CAMERON: Anybody on the Bank of Canada list who was willing to post the necessary margin.

COMMISSIONER BROWN: And this would be without limit on excess -- I just wanted to get a little more detailed picture of how it would operate.

MR. CAMERON: If you are bidding the 3 per cent basis for three-month treasury bills your price is about 99-1/4. So, even to post the full margin between the 99-1/4 price and maturity price at par would only require 3/4 of a point. This might make it attractive for a fellow who

hadn't thought he had a market for bills in the province next week, to bid for bills, and the margin is not onerous; it would cost him $7,500 on a million at full margin, and at that the margin may be only half of that.

COMMISSIONER BROWN: And would you have all these dealers having access to the day-to-day money market?

MR. CAMERON: Yes. I think that under our chartered bank system that would be feasible, and with the Bank of Canada branches.

COMMISSIONER MACKINTOSH: Later on you speak of conflicts of interest in the securities market: Would this be relieved if the underwriters were separated from the distributors and dealers?

MR. CAMERON: I would hope it would be, although our markets are small enough it may take some time before we develop a full complement of brokers, jobbers and underwriters such as the English have.

COMMISSIONER MACKINTOSH: I gather -- or I think I remember gathering from the Radcliffe Report that jobbers were a disappearing race in the English market.

MR. CAMERON: They have been rather badly hit by the activities of the Bank of England at times, and also by the incidence of succession duties which has impaired their capital. I recall from Radcliffe one gentleman, Sir Frederick Leaf Ross who complained vociferously that the Bank of England on one occasion called an issue for redemption and apparently brought out a new issue on which the

jobbers took a park, and within ten days raised the bank rate substantially causing 5 points loss on this bond within a month.

COMMISSIONER BROWN: This is like the conversion loan.

MR. CAMERON: Which, on a five-year bond, is quite a substantial loss. Sir Frederick's complaint was that the Bank of England was rigging the market and trying to take advantage of the jobbers.

COMMISSIONER MACKINTOSH: I gather your view is that it would be desirable if underwriting was separated from distribution, but that you think any divorce of that kind would take quite a while having regard to the size and continuity of our market.

MR. CAMERON: I think that brokers and underwriters should be separated eventually so that you will know whether the customs man, the salesman, is acting as your agent or whether he is the employee of the house engaged to distribute the house's merchandise.

COMMISSIONER MACKINTOSH: Don't they always state whether they are selling this as agents or principals?

MR. CAMERON: It is probably all there in the fine type, but I can assure you the average retail client -- and I remember in the days when I was engaged in the business that involved retail clients -- seldom understood.

THE CHAIRMAN: Just one point I would like to refer to, going back to what you mentioned earlier;

you mentioned it in your additional submission, where you say: "Keynes, in the early 1920's, cites similar price levels for the years 1826, 1841, 1855, 1862, 1871 and 1915, and a somewhat lower common level for 1844, 1881 and 1914. From 1826 to 1914 the maximum price variation in any direction was 30 per cent." Is it not true that during those periods when the price level fell that there were serious depressions in Great Britain?

MR. CAMERON: Indeed there were, sir, and in those days I think the adjustment of the economy is not reflected in the value of money but in the standard of living of the working man and on the number of unemployed.

THE CHAIRMAN: But when the prices were on rise the depression disappeared, or it was alleviated?

MR. CAMERON: And I doubt if the working man got a commensurate increase in wages.

THE CHAIRMAN: He may have got some wages, and he wasn't getting any before.

MR. CAMERON: He got more work.

COMMISSIONER MACKINTOSH: Aside from the early years after the Napoleonic war real wages in Britain rose pretty consistently during the 19th century and including the depression period.

MR. CAMERON: You were getting a real increase in productivity throughout most of that period and the development of new sources of raw materials and more economic ways of transporting them. These were the things that tended to make it easier for the British to, possibly accidentally, keep the purchasing power of the pound within reasonable limits and make

the gold standard work.

COMMISSIONER MACKINTOSH: Well, popular standards have changed. We had a cost of living commission in this country about 1912 tackling the critical fact that the cost of living had risen about 1 per cent per annum over the past 12 or 15 years.

MR. CAMERON: I am afraid you might have to have another five royal commissions in the next year.

THE CHAIRMAN: Apparently that royal commission did not cure anything.

COMMISSIONER GIBSON: I have one question: You say in the brief at page 20 that Canada's N.H.A. mortgage, affording 6-½ per cent to institutions, is far more attractive than long Canada bonds at just over 5 per cent. We have heard quite a few witnesses who don't agree with you, and feel that much should be done to make this N.H.A. mortgage more attractive and more interesting. Do you have any views on this about a market for these mortgages?

MR. CAMERON: My view is, from the institutional point of view, most of our institutions were in the conventional mortgage business long before the N.H.A. They have facilities for servicing mortgages, and it would cost some ofthem possibly one-half of one per cent if they had a large volume, so that they net six, and this does make it more attractive than a government bond at five.

COMMISSIONER GIBSON: Do you see quite a lot of institutional buyers buying these mortgages?

MR. CAMERON: No, they are usually placing

them rather than buying them.

COMMISSIONER GIBSON: Placing them in funds, and so on ?

MR. CAMERON: Well, the figures show there is quite a volume done by the private insurance companies with some exceptions. Those exceptions do a large mortgage business but prefer the conventional mortgage.

As to making the mortgages marketable in the sense they can be sold to the small investor, I think out of a given disposable personal income there is probably only an inclination to save so much, and if you are going to make mortgages more appealing to this type of buyer, and you succeed, you are going to diminish his participation in other forms of saving, be it savings bonds or bank deposits or the issues of other borrowers. I think there is perhaps too much emphasis put on this for what it would accomplish.

COMMISSIONER GIBSON: Thank you very much, Mr. Cameron.

THE CHAIRMAN: Thank you very much indeed, Mr. Cameron; it has been a most stimulating discussion and we are indebted to you for your excellent submission.

MR. CAMERON: Thank you for the privilege of appearing, Mr. Chairman.

THE CHAIRMAN: We will now adjourn until 9.15 tomorrow morning.

--- Adjournment.

Royal Commission on Banking and Finance

Hearings
held at
Toronto

Vol.
12A

Date.
April 16 1962

Official Reporters
F.J. Nethercut and R.J. Young
Toronto, Ont.

SUMMARY

This submission touches on two areas under consideration by the Royal Commission on Banking and Finance:

- Economic growth, and specifically the inadequate flow of capital into certain vital sectors;

- Chartered banks, and specifically their use of inner reserves.

Our analysis suggests that the high investment rate we enjoyed during the 1950's did not produce a sound base for expansion in the 1960's. We find the economy needs revitalization. Fortunately the ingredients are all available, but they require stimulation and direction. We find need for:

- More private investment in areas that will produce Canadian jobs and Canadian goods and Canadian technology;
- More government investment in social capital;
- More capital for small business expansion;
- More capital for mortgages for used houses.

The program we assemble to meet these needs involves specific investment projects totalling more than $4,000 million and provides incentives for desirable investment by private citizens and industry.

Revenue losses are offset throughout--there need be no deficit financing--and the basic program could be implemented immediately.

We begin by examining the chartered banks. We find their accumulated tax-free inner reserves are excessive. Under current practice they constitute a permanent government subsidy, on which the banks over the next 10 years could net $100 million. We find the inner reserves cloaked in needless secrecy which misleads the public and shareholders. We find they contribute to excessive bank earnings. Lastly, we find the banks deliberately use inner reserves to disguise the true course of earnings and profits. Against a declared rate of return of 6.9 per cent, we find an actual rate of 10 per cent.

We propose that tax-free inner reserves be limited to three times the average annual loss experience for the previous 25 years. The tax liability this would establish on present reserves--about $150 million--should be paid within 10 years in equal annual amounts. We also suggest fuller disclosure of inner reserves.

We propose the government use $50 million to guarantee private lenders against loss on mortgages for used houses, and $100 million to guarantee private lenders against loss on loans for small business expansion. This would result in mortgages and loans worth $3,500 million.

We attempt to meet our other goals by a better tax mix, to stimulate growth, and through more government investment in social capital, to provide research facilities and improved education and technical training.

We provide investment incentives through personal tax reductions and accelerated depreciation.

To meet these revenue losses, we suggest taxation of capital gains and an increase in the manufacturers sales tax. We propose to shift some of the tax burden from income to consumption.

Besides the stimulus of this program to growth, there would be a net gain in government revenues throughout. This would finance the government's social capital program. Within five years, this investment would amount to $800 million in current dollars. Using only a conservative multiplier, this alone would raise GNP by $1,600 million.

The introduction discusses the economy and some of its needs. Recommendations dealing with the banks and the mortgage and loan program are under "Recommendations I." Those dealing with the tax structure are under "Recommendations II." Each is preceded by an analysis of the area concerned, and followed by a discussion of the program's effects. Documentation and tables are contained in the appendices.

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4. The steps a country in economic difficulties must take can never be popular. We believe, however, that the people are prepared to accept direction back to the high road to prosperity. Whatever recommendations are made and whatever structure is devised, the result will not be perfect to all. To do nothing, however, is to do harm to all.

5. To a large extent, the success of economic policy depends on the reactions of the private sector. To a larger extent, it depends on the leadership and role of the federal government.

6. We do not start with any predilection for government as against private investment. We do not think that men in government are better than private entrepreneurs at judging the outcome of particular investment projects. We do think government is better able to judge the outcomes of various constellations of investment programs. It is also better able to assume the risks associated with them, since many of the rewards accrue, not to the particular projects in which the initial investment is made, but to the nation as a whole.

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8. Its recommendations, particularly in the area of banking and credit, reflected a consensus that the government's role is large and that it has a prime duty to do all it can to spur growth.[1] It is to this task of providing leadership and incentives that we have directed this submission.

9. For more than a decade Canada experienced prosperity with little effort. We had a high volume of public and private investment. We enjoyed full employment and worried about demand inflation. Yet we ran into difficulties. We discovered the lasting truth of John Stuart Mill's dictum, "The demand for commodities is not the demand for labor." More importantly, we ran into economic problems at a time when other countries were regaining prosperity and growth.

10. The result is that at a time when international opportunities are calling, we are not able to respond. The high rate of investment during the 1950's did not produce for the 1960's an economic structure emphasizing Canadian jobs and Canadian goods and Canadian technology. Now the rate of investment is dropping dangerously.

11. The problem is to make the nation move ahead again. We have the capacity to do so. If the world were frozen in present stages of economic development, we would be the second most prosperous nation. We have a high level of know-how and technology. We have vigor and desire. Since the world is not frozen, but ever more dynamic and competitive, the task is to redirect our capacities towards the goals of economic prosperity: Full employment, rising growth, stable prices.

12. Our analysis concludes the nation's main concern is a lack of investment producing Canadian jobs and Canadian goods. We find an improper mix of taxes and incentives which impedes the best flow of resources for expansion and development. We believe the answer lies in added incentives, to industry and citizens, to invest in areas that will produce Canadian jobs and Canadian goods and Canadian technology.

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13. We also believe more investment is needed in social capital. Canada, as W.W. Rostow noted in his analysis of economic growth, entered the stage of mass consumption before technological maturity was attained.[2] We have not, on the whole, invested enough in the social foundation that sound economic growth requires. A skilled and efficient labor force depends on the quality of secondary and university education. New industries and technology depend on research and development.

14. Too frequently investment is thought of only in terms of machinery and equipment. Too frequently education is classed as consumption rather than as investment. In recent years too much lip service and not enough money has been devoted to improving and widening university and technical training. Overwhelmingly we must invest in people. They are our most precious resource. The Royal Commission on Canada's Economic Prospects said:

15. "The Canadian economy must accomodate itself continuously to the conditions of a highly competitive world in which the pace of growth and development will be determined largely by the ability to use the fruits of scientific research and technological improvements. The free flow of scientific and technical information between countries is in the interests of all. Canada has gained and will continue to gain from the process. But the rate of growth in Canada would be retarded if Canadian industry were to rely to too large an extent on innovations originating in other countries. In our own interest we must make a significant original contribution to technological advance. This means expansion of support for research and of the numbers of qualified research scientists, and an adequate supply of the skilled workers necessary to apply the new knowledge and techniques."[3]

16. Last year's Bank of Canada report emphasized the continuing need:

17. "Investment in human capital can at times do more for growth of output than investment in physical capital. Improved education in general, higher education for a larger proportion of those leaving high school, technological development and training, scientific

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research, and the development of skills and aptitudes of the widest diversity as required in modern industry, can produce very marked increases in productivity and in total production. Such an improvement in human capital can help to develop new forms of industry and rapid expansion in the advanced technologies more effectively than can be achieved by straining for more and more physical investment whether provided by foreign investors or otherwise."[4]

18. We believe investment in social capital has been lagging. The glamor of space and defence needs of the cold war have caused some increased awareness of the need for research and development. An example is the Defence Industrial Research Program, under which Canadian firms can get government help at scientific and financial levels for projects with reasonable sales potential.[5] But Canadian research and development (as a percentage of GNP) is only one-third that of the U.S. or Britain. It is vital to urge greater effort, and not only in the military field. To spend proportionally half what the U.S. devotes to research and development would require additional expenditures of more than $200 million. (See Appendix I.)

19. To accomplish all our goals requires action by government, industry and citizens. The government can determine the extent of its own contribution and fulfill it. It can only provide incentives, however, to insure that industry and the populace carry out their roles. We believe these incentives are missing in today's financial structure. We believe they must be carefully shaped to produce the desired effects. But they must be provided.

20. "Neither coercion nor cajolery is consistent with the principles of a free economy. Freedom implies that the individual can choose his occupation or choose between working and not working; and the amount of work he does is related to his material rewards and expectations. If the most effective use is to be made of human resources the question of economic incentives to the individual therefore cannot be brushed aside."[6]

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21. We propose to examine areas where meaningful steps could be taken to provide these incentives. If it is possible to also correct inequity in the existing structure, we attempt to do so. We suggest the following program to raise public and private investment, aimed at Canadian jobs and Canadian goods and Canadian technology:

- A reduction in personal income tax rates;
- Canadian dividends and interest tax-free up to $50;
- Accelerated depreciation for certain types of capital assets;
- Increased government investment in social capital;
- Government programs to raise the flow of funds into mortgages and small business expansion.

22. To obtain revenues for this program we propose:

- Taxation of capital gains of more than $500;
- An increase in the manufacturers sales tax;
- Withdrawal of tax exemption from excessive inner reserves of the chartered banks.

23. We propose to use the special tax from the chartered banks to finance mortgages and small business expansion. Our program would produce $3,500 million in mortgages and loans.

24. The rest of our program would increase the flow of private investment into industry and the amount of government investment in social capital. Neither deficit financing nor a redirection of present government revenues would be necessary. In fact, there would be a net gain in government revenues, to finance its expanded social capital program. This new government investment would total $800 million within five years. After a conservative multiplier effect, this would add more than $1,600 million to GNP.

25. It would be irresponsible to claim the nation could move itself ahead effortlessly. The argument on whether the key, however, is to increase demand or supply is as old as economics.

26. The right emphasis varies with specific situations and aims at some balance--a program where supply stimulates demand and demand sets the stage for further increases in supply. The essence of the argument, in fact, dates to Ricardo and Malthus:

27. Malthus stated: "Yet it will be most readily allowed that the saving from revenue to add to capital is an absolutely necessary step in the progress of wealth. How then is this saving to take place without producing the diminuition of value apprehended?

"It may take place, and practically always does take place, in consequence of a previous increase of value, or of revenue, in which case a saving may be effected, not only without any diminuition of demand and consumption, but under an actual increase of demand, consumption and value during every part of the process. And it is in fact this previous increase of value and revenue which both gives the great stimulus to accumulation, and makes that accumulation effective in the continued production of wealth."

Ricardo commented, "This is the way undoubtedly."

Malthus added, "The fortune of a country, though necessarily made more slowly, is made in the same way as the fortunes of individuals in trade are generally made--by savings, certainly; but by savings which are furnished from increased gains, and by no means involve a diminished expenditure on objects of luxury and enjoyment."

Ricardo commented, "It will however be allowed that an individual may improve his fortune by a diminished expenditure on objects of luxury and enjoyment. Why may not a country do the same?"[7]

28. Canada has reached a standard of living where it is reasonable to tax consumption to finance progress. As an economic and social goal, inequality has been declining in urgency. The urgent need is to revitalize the economy on a sound foundation.

29. "From a dollars-and-cents point of view, it is quite obvious that over a period of years, even those who find themselves on the short end of inequality have more to gain from faster growth than from any conceivable income redistribution."[8]

30. We recognize, with regret, that today those at the bottom may be particularly unable to make their plight heard and known. Their unhappy situation is a

task for other government legislation than may be your concern. But the pattern of repetition can be broken only through an increase in social capital. To eliminate the residuals of poverty the nation must invest in high-quality schools, strong health services, slum clearance, expansion of low- and middle-income housing.

31. An ideal investment and tax scheme is perhaps not immediately attainable. We would prefer, for instance, a combination of net worth and expenditure taxes in place of the income tax. There are still too many practical difficulties to recommend this. We do urge the Royal Commission to recognize the pressing need for change and to provide practical guidelines.

CHARTERED BANKS

32. Canada's chartered banks enjoy a position of privilege and a role of public trust. This is reflected in special legislation dealing with banks and in the mandate of this Royal Commission. It was acknowledged by the president of the Canadian Bankers Association in 1944, S.W. Wedd, who identified the chartered banks as "quasi-public servants."[9]

33. Our main concern with the banks is the system of tax-free inner reserves. This allowance has so far deviated from its original purpose that it now constitutes a permanent government subsidy. It is used to hide from the public and shareholders the true nature of bank earnings, and it has contributed to excessive earnings.

34. Inner reserves represent an accumulation of annual charges to operating earnings, to guard against losses on loans and investments. The policy is sensible. Since loans made in a specific year may become bad debts in a future year, it is reasonable to allow the banks to provide for probable loss before computing their tax liability.

35. The complexities of administering this policy, however, have led to a situation where the banks are allowed to accumulate a tax-free amount out of all proportion to the losses they might suffer. The banking structure has changed, economic controls have developed, but the banks continue to calculate tax-free inner reserves as if a depression worse than that of the 1930's was around the corner. The result is a permanent reserve of more than 30 times average annual losses of the last 25 years. U.S. commercial banks since 1947 have been allowed a reserve against losses of three times the average loss ratio of the previous 20 years. Other Canadian companies may only claim tax-free reserves based on estimated losses.

36. To the extent that tax-free inner reserves overstate probable losses, they constitute an unwarranted tax benefit or subsidy. The average annual loss experience from 1936-60 was .167 per cent. We calculate the accumulation of tax-free inner reserves at the end of 1960 was more than $325 million or almost 5 per cent of related assets. (See Appendix II.)

37. The excess against what is actually required appears to be $300 million. Since under current practice this need never be reduced, it provides the banks with $150 million they would otherwise have to pay in taxes. In essence, this means a permanent interest-free loan from the government. The use of this money for 10 years, at a 5 per cent net return after taxes, would yield another $100 million.

38. The status of tax-free inner reserves has been discussed at every revision of the Bank Act in this century, with special attention in 1944 when they were the subject of a formal statement by Hon. J.L. Ilsey, Minister of Finance. The statement received less attention than it deserved, having been delivered June 6, 1944.

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39. There are other undesirable aspects to the inner reserves.

40. The secrecy surrounding them is unnecessary and unfair to both the public and 100,000 holders of bank shares (as estimated by the Canadian Bankers Association in 1960). While the Bank of Canada reports the annual charge to earnings for inner reserves of the chartered banks as a group, individual banks do not make public either the annual appropriation or the accumulated balance. In effect, a bank's annual report shows assets and earnings after inner reserve transfers.

41. The inner reserves, however, increase a bank's working capital, which is particularly important to accurately determine the book value of a chartered bank. In the last six years, for every $1 of net earnings reported by the banks, an average of 32 cents has been added to inner reserves.

42. Some bank officers might argue this is of no concern to shareholders. The president of the Canadian Bankers Association in 1954, T.H. Atkinson, said:

43. " . . . the contingency reserves are not part of the banks' capital funds in the sense that they do not belong to the shareholders. They are built up to cover losses in investments which are bound to take place from time to time. They tend to be large when times are good and loans are rising and they are inevitably drawn upon when times are less favorable."[10]

44. To the extent that reserves permanently exceed losses, they do belong to shareholders. Assessments of bank stocks try to take the inner reserves into account, but for individual banks are frustrated by lack of information. The present annual statements amount to misinformation and are neither in the public nor the shareholders' interest.

45. The banks use the inner reserves to show a steady but restrained growth in earnings. This is done through irregular transfers. In years of high operating earnings, net transfers to inner reserves are high.

In years of low earnings, net transfers are low or there may be a transfer out of inner reserves into current earnings.

46. The banks have gone even further in using inner reserves to disguise the true course of earnings. The net transfer to inner reserves has not consisted of one lump transfer to meet possible losses, but often of a double shift, to depress earnings to a desired level. First a sum is deducted from pre-tax operating earnings and placed in inner reserves. Then a smaller sum is transferred from inner reserves to shareholders' equity. Taxes are paid on the amount moved into shareholders' equity, of course, but the effect on declared earnings is striking. There is the unusual situation of shareholders' equity growing more than the net profits less dividends. From 1956-60 shareholders' equity increased by $60.2 million from net profits remaining after dividends. But equity increased by at least $138.9 million as a result of retransfers from inner reserves. (See Appendix III.)

47. This procedure is objectionable and the banks should be discouraged from its practice.

48. How far the public picture is from the truth can be seen in an examination of actual earnings. Declared net earnings after taxes for the last decade averaged a reasonable 6.8 per cent. When retransfers are included, earnings averaged a not-so-reasonable 9 per cent. If actual losses rather than reserve provisions are charged, earnings averaged a definitely unreasonable 10 per cent. (See Appendix IIIA.)

49. This return for a relatively secure enterprise like banking is strikingly high compared with other business groups or the 7 per cent limit for regulated utilities. (See Appendix IV.) It provides a marked contrast with the situation in 1944 when Mr. Ilsey remarked:

50. "I suggest that our main concern is to see whether the earnings of the banks before appropriations to inner reserves are excessive at 6 per cent on the shareholders' equity."[11]

51. This is how the Royal Bank of Canada used the device last year. To begin with a commendation, only the Royal Bank in recent years has at least included the retransfer from inner reserves in its statement of undivided profits, before the second shift into rest fund. This is what the directors' report said for the year ended Nov. 30, 1961:

Profits for the year, after provision for depreciation and[x] income taxes and after making transfers to inner reserves out of which full provision has been made for diminuition in value of investments and loans	$20,759,844	(1)
Dividends	16,629,613	
	4,130,231	
Transferred from inner reserves after provision for[x] income taxes exigible	10,000,000	(2)
[x] Total provision for income taxes	$30,750,000	(3)

52. Since the Royal Bank paid taxes at roughly a 50-per-cent rate, it only takes some minor arithmetic--but much careful probing--to see that net profit reported to the government was about $61,500,000, which would leave $30,750,000 and balances the provision for taxes, line (3). The difference between this and the profits the bank reported to shareholders, line (1), is what passed through the inner reserves, line (2).

53. The declared net profit per share, $3.12, was based on line (1). The shareholders received $2.50 while apparently 62 cents went to retained earnings, a division not likely to arouse anyone.

54. Actual net profit per share should be calculated not on line (1) but on line (3), which would total $4.63. Deduct $2.50, and the true amount that went to retained earnings--without the public or shareholders really seeing it--was $2.13.

55. Similarly, the declared return on shareholders' equity based on declared profits, line (1), is a healthy but restrained 6.9 per cent. Use the real profit, line (3), and it turns into an eyebrow-raising 10.2 per cent. Truly a case of now you don't see it, now you do.

56. Since the comparable figures for lines (1) and (2) have added to line (3) in recent years, it's probable the Royal Bank, like most banks, is at or near its maximum tax-free inner reserves. And this bank, it should be noted, is reporting more openly than any other.

57. In passing, we suggest the present rate of return would allow the banks to raise interest rates on savings accounts, to provide more capital to small business and to operate within a maximum interest rate of 6 per cent on loans.

RECOMMENDATIONS I

58. The Minister of Finance should restrict tax-free inner reserves to three times the average annual loss experience of the previous 25 years on related assets, or to an amount calculated by an account-by-account review, whichever is greater.

59. The tax liability thus established on current inner reserves should be paid in equal amounts over a period not exceeding 10 years.

60. The government should earmark this revenue for two funds: (a) One fund of $50 million to be administered by CMHC to guarantee private lenders against loss on approved mortgages on purchases of used houses; (b) The balance, about $100 million, to be used to guarantee private lenders against loss on approved loans for small business expansion.

61. The Bank of Canada should report the annual loss experience of all chartered banks as well as the average annual 25-year loss experience.

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61. The Bank of Canada should report the annual loss experience of all chartered banks as well as the average annual 25-year loss experience.

62. The Bank of Canada should report annually the total inner reserves held by the chartered banks, specifying the tax-free portion.

63. The individual banks should annually report accumulated reserves, either as a note to the balance sheet or as a deduction from assets. They would not be required to disclose the split between tax-free and tax-paid reserves, and they would not be required to change their method of declaring net profit or shareholders' equity.

64. The banks should be discouraged from passing operating earnings to shareholders' equity by retransfers from the inner reserves.

65. We do not quarrel with the banks' right--and even obligation--to set aside the reserves they feel they require. Nor do we quarrel with their desire to project the image of a soundly-managed institution, showing a progressive increase in earnings without severe fluctuations. But what constitutes an adequate tax-free allowance is, after all, a matter of opinion.[12]

66. It is probably easier to obtain a consensus on what constitutes an inadequate reserve, or an excess reserve. The present situation, we suggest, is clearly in excess. Limiting tax-free reserves to one year's loss experience, granting the conservative history of chartered banks, would be inadequate. We believe three times the annual average of 25 years' loss experience is a reasonable tax-free allowance.

67. The tax liability this would establish on existing reserves, paid over 10 years, would still leave the banks with adequate funds to meet their responsibilities, especially in light of their true earnings. This liability would be less than 1 per cent of total assets. If they had paid it over the last 10 years earnings would still have been 9 per cent. And the banks would benefit from the new use of the funds.

52. The Bank of Canada should report annually the total inner reserves held by the chartered banks, specifying the tax-free portion.

63. The individual banks should annually report accumulated reserves, either [illegible] balance sheet or as a deduction from assets. They would not be required to disclose the split between tax-free and tax-paid reserves, and they would not be required to change their method of declaring net profit or shareholders' equity.

64. The banks should be discouraged from passing operating earnings to shareholders' equity by retransfers from the inner reserves.

65. We do not quarrel with the banks' right--and even obligation--to set aside the reserves they feel they require. Nor do we quarrel with their desire to project the image of a soundly-managed institution, showing a progressive increase in earnings without severe [illegible] tax-free allowance is, after all, a matter of opinion. 12

66. It is probably easier to obtain a consensus on what [illegible] inadequate [illegible] reserve. The present situation, we suggest, is clearly in excess. Limiting tax-free reserves to one year's loss experience, granting the conservative history of chartered banks, would be inadequate. We believe three times the annual average of 25 years' loss experience is a reasonable tax-free allowance.

67. The tax liability this would establish on existing reserves, paid over 10 years, would still leave the banks with adequate funds to meet their responsibilities, especially in light of their true earnings. This liability would be less than 1 per cent of total assets. If they had paid it over the last 12 years earnings would still have been 9 per cent. And the banks would benefit from the new use of the funds.

68. This new method of computing tax-free inner reserves would have little or no effect on the banks' tax liability in future years on current operations. Tax-free inner reserves appear in recent years to have stayed close to the limit allowed under present regulations. The opportunity for tax reduction is thus limited by the annual increase in assets. The main effect on cash flow would be the necessity to meet the liability on existing reserves.

69. Similarly the liability need not affect dividends. The banks could charge the tax to inner reserves, so as not to diminish declared shareholders' equity.

70. More specific disclosure of the annual loss experience and the amount of inner reserves is necessary to preserve the banks' faith with the public and shareholders.

71. It has been argued that non-disclosure is needed because annual fluctuations in inner reserves might mislead the public. It might even result, it was argued, in a flight of capital from a particular bank.[13]

72. Mr. Ilsey, for instance, warned what might happen should a gimlet-eyed citizen catch a dip in the amount of inner reserves:

73. "We know how easy it is to distort facts about technical matters and to start rumors that have no foundation. We know that once started, baseless rumors give rise to whispering campaigns that are likely to cause an untold amount of damage, particularly to persons with small incomes and small savings. I am convinced that we should not lightly take such risks."[14]

74. Mr. Ilsey's words might just as easily have been used to favor full disclosure. Certainly it is easier to start rumors when the facts are not known than when they are. The speculative information now available is far more likely to mislead the public than specific information. A method of annual accounting that tries to keep the public from going down one garden path by leading them down another has nothing to commend it.

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75. Mr. Ilsey's statement even ended on a somewhat different note. He announced his intention to collate and publish bank statistics to "enable parliament and the public to obtain regularly the information which is significant for determining whether the banks are making too much profit and whether they have too much left over out of earnings available for inner reserves to take care of their probable requirements over a period of years."[15] Granting the ambiguity of the last phrase, the key figure that surely would be needed for accurate assessment would be total inner reserves.

76. Mr. Ilsey also argued that inner reserves against bad or doubtful debts are rarely disclosed in ordinary business.[16] But the trend today, encouraged by bodies like the Toronto Stock Exchange, is to more disclosure. "The outstanding trend in accounting thought over the past few decades in this country as in Great Britain and the United States, has been towards fuller disclosure in company accounts."[17] Showing reserves is more likely to produce confidence than merely stating there are reserves without any details.

77. It has also been argued that the existence of inner reserves increases a bank's willingness to accept higher risks.

78. That banks take any more risk than they cannot avoid is a debatable proposition at best. At any rate, we would not take away the individual bank's right to determine what reserves it requires to safeguard its operations. Nor would the bank have to indicate publicly how much of the reserves constituted a tax-free allowance. All we suggest is that it is not the government's task to subsidize bank policy, particularly when there are more important areas that require scarce resources.

79. In any case it is hardly likely that the excellent reputation of Canadian banks rests on the

inner reserves. If this was such a key item in holding public confidence the entire banking structure should have come down in 1933 when--in the only recorded such instance--five banks transferred $29.5 million from published rest funds to bolster inner reserves. Other factors must surely be at work, particularly since from 1929-43, despite the depression, inner reserves still increased by $10.3 million while the rest fund remained steady after 1933.

80. The best place to find an answer is from the government and Bank of Canada. The government's informal commitment to protect the public is behind confidence in the chartered banks. Naturally this commitment has never been made explicitly--there would then be little need for shareholders--but it was consciously implicit to a generation that knew one depression and didn't care for another. The Bank of Canada's first governor, Graham Towers, on several occasions pledged support should a chartered bank ever experience a run on deposits. Mr. Ilsey summed up the situation in 1944:

81. "As a last resort, the central bank may come to the rescue but reliance on the central bank should not be a steady diet or be any excuse for failure of the chartered banks to maintain themselves in a sound and strong condition."[18]

82. As a last note, the best guarantee against the banks ever running into difficulties is a healthy economy. We suggest the mortgage and loan programs we recommend are a better way to achieve this than any system of withholding information.

MORTGAGE AND LOAN PROGRAMS

83. The government programs we recommend, paid for by the banks' added tax liability, would benefit not only the economy in general but the chartered banks in particular.

inner reserves. If this was such a key item in holding [illegible] have come down in 1933 when--in the only recorded such [illegible] factors must surely be at work, particularly since from 1929-42, despite the depression, inner reserves still increased by $20.3 million while the rest fund remained steady after 1932.

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MORTGAGE AND LOAN PROGRAMS

53. The government programs we recommend, paid for by the banks' added tax liability, would benefit not only the economy in general but the chartered banks [illegible]

84. Using $150 million to guarantee mortgages and loans to small business in effect would mean mortgages and loans worth $3,500 million. Much of this, as it multiplied through the economy, would reach the banks as deposits, particularly if they raised the interest rate on deposits. The net result, we conclude, would be a vital transfusion to needy areas, from funds now in less productive use.

85. (Some of the windfall revenue would belong to the provinces under the federal-provincial tax agreements. We suggest the provinces would contribute their portions to the mortgage and loan programs, since both would bring almost as much direct benefit to the provinces as could any provincial use of the funds.)

86. Certainly the areas for which the funds would be earmarked deserve speedy consideration.

87. Housing is one of the economy's vital sectors. In 1960, after the first and mid-year surveys of investment predicted an increase over 1959, a sharp drop in housing expenditures was enough to bring total investment below the 1959 level.

88. We believe one of the main difficulties is the split in markets between relatively new houses with NHA guarantees and relatively older houses without. Buyers do not divide so simply. Difficulty in obtaining a mortgage at a reasonable rate for a used house distorts the market for new houses beyond all reason. People rent instead of buy, or permanently postpone their purchase, or take mortgages with high interest rates and low coverage and the inevitable necessity for a second mortgage. The evils of this practice constitute a shocking indictment of the private mortgage field.

89. Using relatively little money and the proven administration of CMHC, the federal government could bring about a vast change. Our mortgage program would

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also supplement and complement the government's effort to create a secondary mortgage market in Canada.

90. We propose that the government pledge $50 million of its revenue to an insurance fund to guarantee loans for approved mortgages on purchases of used houses. Our aim would be a high guarantee against loss to insure equitable terms for buyers and adequate incentive to investors. We calculate $2,500 million in mortgages--200,000 houses carrying an average mortgage of $12,500--would result from a program along the following lines:

91. Mortgages would be granted to 80 per cent of the value of the house up to a maximum mortgage of $16,000. The interest rate should be the same as on NHA mortgages. The insurance charge should be 3 per cent instead of the present 2 per cent on NHA mortgages, to provide additional protection for the investor. Should the loss ratio prove the same as on NHA mortgages, the insurance charge should be reduced. As in NHA mortgages, liability would be limited to the size of the insurance fund.

92. If the insurance fund was 5 per cent of outstanding mortgages, it would thus have $50 million from the government and $75 million from insurance charges, or provision for $2,500 million in mortgages.

93. The terms would provide adequate incentive to pension funds, credit unions and trust and insurance companies. All are growing rapidly and are seeking relatively secure investments. This mortgage program would ideally suit their needs.

94. Money now going into second mortgages for used houses represents investment in risk ventures. This would not be withdrawn from the investment field, but would turn to other venturesome areas. Particularly if our recommendations were followed to make industrial investment more attractive, there would be ample outlets for this money.

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95. The government's responsibility to insure adequate funds for small business expansion has been recognized since 1944, when the Industrial Development Bank was established as a subsidiary of the Bank of Canada. Last year this was supplemented with the Small Business Loans Act. We consider this area--so vital to the economy's growth--still insufficiently provided with expansion capital.

96. Small business is every bit as inventive and productive as large. But left to itself, small business only has local or personal sources of capital. It is at a disadvantage compared with large business with access to regional, national or even international money markets.

97. We suggest using the balance of the added bank liability--about $100 million--to guarantee private lenders against loss on approved loans for small business expansion. The structure would follow that of the Small Business Loans Act but certain limits should be expanded.

98. As in the present act, loans should be for improvement and modernization of equipment and premises for businesses in manufacturing, wholesale or retail trade and service industries. It would not apply to professional, charitable or religious groups.

99. Loans should continue to be made for up to 80 per cent of the purchase price of equipment and 90 per cent for premises. The 10-year term and 5½ per cent interest rate should be continued. The gross revenue limitation should be increased to $2 million, compared to $250,000 under the original act. Maximum loans should be $100,000 compared to $25,000 now.

100. The present act limits the guarantee to 10 per cent of the loans made by a bank with the program effectively limited to loans of $300 million. Using the same criteria, a fund of $100 million would allow $1,000 million in loans.

101. There is as yet insufficient data to judge the response of chartered banks to the Small Business Loans Act. They would appear to have sufficient funds to participate--ratio of liquid assets to deposit liabilities is a high 19 per cent. If the response proves disappointing, the program should be opened to other federally regulated lenders, such as trust and insurance companies, and/or the interest rate could be raised.

102. The banks, however, to fulfill their public role, should be encouraged to back this program, if necessary by shifting out of loans to large public companies. Such companies have adequate alternative sources of capital. The shift would mean a slight increase in administrative costs to the banks, but our analysis of their earnings indicates they could easily absorb this.

TAXATION

103. Our next area of concern involves the effects of certain aspects of taxation on the flow of investment available for social and physical capital. The aim of our proposals is to increase investment in areas where Canadian goods, jobs and technology would benefit. We provide incentive for saving--and thus for investment--by shifting some of the burden of taxation from income to consumption.

104. Our concern here is not the tax structure as such, although by its very nature, adjusting one tax requires adjustments to others to maintain revenues. Consequently our proposals touch on the personal income tax, capital gains, capital cost allowances and the manufacturers sales tax.

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RECOMMENDATIONS II

105. Personal tax rates should be reduced according to the scale set out in Appendix V. This would result in a maximum rate of 60 per cent compared to the present 80 per cent, with substantially lower rates for middle-income groups and lesser decreases for lower-income groups.

106. The first $50 of income from Canadian dividends or interest should be tax-free.

107. The capital cost provisions for new Class 8 machinery and equipment should allow a special 50 per cent write-off in any year, in addition to the present 20 per cent annual allowance.

108. Capital gains of more than $500 should be defined as investment income and included in taxable income. A proposed method of taxation is outlined in the section on capital gains. It provides for averaging the gain, allows capital losses to be deducted from capital gains with unlimited carry-forward, and has special provisions for personal property such as houses.

109. The manufacturers sales tax should be increased to 14 per cent from 11 per cent.

110. Exemption from the sales tax of purchases of imported Class 8 machinery and equipment employed directly in production should be cancelled, unless the machinery and equipment is used to produce exports and cannot be made in Canada.

111. Tax revenues in the first year of this program would balance as follows:

Losses: (millions)		Gains: (millions)	
Personal taxes	$175	Capital gains	$100
Capital cost allowance	200	Sales tax	300
	$375		$400

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from economic growth, the net gain in revenues would eventually reach $225 million in constant dollars-- more than double the federal government's 1961-62 budget for university and technical training and national research. We could conservatively assume continuation of a 3 per cent growth rate and a nominal amount of new industrial investment, so losses from the special capital cost allowance would be eliminated by the fifth year. The government's new investment in social capital would then amount to $800 million in current dollars during this five-year period.

113. Some of these proposals would affect provincial revenues under the federal-provincial sharing agreements. This aspect is examined after the section on capital cost allowances.

PERSONAL TAXES

114. The changes we recommend in personal income tax rates should stimulate investment. Disposable income would increase at all brackets but the lowest. We balance this reduction with higher taxes on consumption. At the middle and upper levels, there would be a net gain. We make it attractive to channel the gain into profitable investment. If the person instead chose to increase consumption, his gain would be taxed. At the lower levels, the reduction in income tax is offset by the increased sales tax. A net gain would occur only if consumption was foregone for investment.

115. In some aspects, this might seem inequitable. Unfortunately, so is any tax structure yet devised by man. The main goal is to again make the nation vigorous and competitive. Everyone gains from growth. If we wait to devise the perfect method for spreading the burden of spurring growth, we will go nowhere.

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116. "It is the increase in output in recent decades, not a redistribution of incomes, which has brought the great material increase, the well-being of the average man. . . . Production has eliminated the more acute tensions associated with inequality."[19]

117. The anomaly of present high personal tax rates is that they produce neither revenue nor equality nor economic investment.

118. Only 2 per cent of personal tax revenue comes from incomes of more than $100,000, and 27.5 per cent from incomes between $10,000 and $100,000. Our adjustments to the rates on taxable income of more than $5,000 would reduce revenues by only 2.5 per cent or $45 million. This would more than be recovered by our proposal to tax capital gains, most of which occur in these income brackets.

119. The present structure does not produce equality because there are so many ways to evade taxes. The actual burden of the income tax--and its progressivity--is much less than it appears from the rate tables.

120. The structure discriminates in favor of people who are better situated to arrange the way they will take their income. The obvious method is through capital gains, which are not taxed at all. Division of property among members of a family, judicious use of trusts, various executive compensation plans and liberal depletion allowances are other ways to lower tax rates.

121. A blatant loophole is the case of persons dealing in stocks for gain. Present regulations make many of these transactions taxable, such as the investor who buys a new issue intending to sell a week later. But it is practice, because of administrative difficulties, to overlook rather than tax.

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122. Current rates are also a disincentive to economic investment. The only incentive of high marginal rates is to lower taxable income. The result is more effort seeking non-taxable income than profitable investment, since it can be two to five times more worthwhile to avoid tax rather than to make money.

123. A $25,000-a-year executive pays $50 in taxes if he earns another $100. If he finds a way to get $100 capital gain, he keeps everything. When he becomes a $400,000-a-year board chairman, he keeps only $20 out of every $100, one-fifth what he could keep from a $100 capital gain.

124. The result is a distorted allocation of resources. The high-bracket individual will try a speculative investment or set up a complicated transaction to get $2,000 in capital gain rather than make a sound investment yielding $3,000 in income. Clearly it is not economic to allocate such extensive individual and professional resources to tax avoidance.

125. Our recommendations recognize the facts of the income tax structure and seek to make economic investment more attractive. The reduction at middle and upper levels is designed to spur the incentive to invest in desirable areas and to provide the funds to do so. The proposed taxation of capital gains would eliminate the greatest bar to rational economic choice.

126. Our proposed highest rate is 60 per cent, on taxable income exceeding $125,000. This compares to the present maximum of 80 per cent, on taxable income exceeding $400,000, with 60 per cent reached at $60,000. The assurance of retaining 40 cents out of every $1, no matter how high the income, would provide incentive to assess investment through the best allocation of resources, rather than incentive to avoid taxable income.

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127. Taxes would be reduced by 15 to 22 per cent above $5,000 in taxable income, and by 7 to 14 per cent at lower levels, except for the very first bracket. (See Appendix V.)

128. The lower rates on taxable income under $5,000 would reduce revenues by 7 per cent or $130 million. This is equal to the effect of a 2 per cent sales tax increase on consumer goods.

129. We do not recommend any change in the lowest rate of 14 per cent, which applies on taxable income to $1,000. This income level is undertaxed compared with benefits received. U.S. rates, by comparison, start at 20 per cent. Comparison with the U.S. and Britain at incomes up to $5,000, including family allowance, shows Canadians in a preferred position at present rates. (See Appendix VI.) It is as fair to ask these income groups to pay their way through consumption taxes as through income taxes. At worst, if principle is ignored and actual dollar cost examined, the net increase in tax would be only $7 to $25 a year. (See Appendix VII.) We believe more equality is desirable in personal taxation, but it should be obtained through the estate tax.

130. The first $50 of Canadian investment income, either dividends or interest, should be exempt from taxable income. Investment income of this amount is rarely taken into income in any case. It would be better to make this a positive element by giving small investors more incentive. A man with $1,000 to invest, for instance, would probably not pay any tax on his investment income. There would be little change in government revenues; there should be a gain in investment incentive.

CAPITAL GAINS

131. Favorable treatment of capital gains reduces the progressiveness of the income tax. It is discriminatory, because it favors people who through luck or preferred position receive them.

132. A U.S. study shows most capital gains come from common stocks, with real estate a poor second and other property of minor importance.[20] They occur in a highly progressive fashion among income groups, so that those who least need such a preference get it. Capital losses concentrate in middle-income groups. Capital gains constitute a major source of income for higher-income groups.[21]

133. Logically capital gains should count as income, whether income is defined as consumption-plus-increase-in-wealth or as flow-of-wealth. The increase in value of any property increases a person's well-being just like an increase in any other kind of income, unless the general price level has risen in the same proportion (and in some cases, unless the interest rate has fallen). If a person buys stock for $5,000 and sells it for $10,000, the gain is available for consumption, or any other use, just as if he had received an additional $5,000 in salary or profits from a business.

134. Nor is it just to exclude capital gains from taxation on economic grounds. If taxation of capital gains lessens the supply of capital for business expansion--and we do not agree that it does--so does all taxation of business earnings.

135. The difficulties arise in taxing capital gains in a system where liability is based on realization and rates are progressive. It is even more difficult, however, to justify not taxing capital gains, particularly when it is possible to develop an equitable method.

CAPITAL GAINS

131. Favorable treatment of capital gains reduces the progressiveness of the income tax. It is [illegible] through luck or preferred position receive them.

132. A U.S. study shows most capital gains come from common stocks, with real estate a poor second and other property of minor importance.[20] They occur in a highly progressive fashion among income groups, so that those who least need such a preference get it. Capital losses concentrate in middle-income groups. Capital gains constitute a major source of income for higher-income groups.

133. Logically capital gains should count as income, whether income is defined as consumption-plus-increase-in-wealth or as flow-of-wealth. The increase in value of any property increases a person's well-being just like an increase in any other kind of income, unless the general price level has risen in the same proportion (and in some cases, unless the interest rate has fallen). If a person buys stock for $5,000 and sells it for $10,000, the gain is available for consumption, or any other use, just as if he had received an additional $5,000 in salary or profits from a business.

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135. The difficulties arise in taxing capital gains in a system where liability is based on realization and rates are progressive. It is even more difficult, however, to justify not taxing capital gains, particularly when it is possible to develop an equitable method.

136. It is frequently argued that favorable treatment of capital gains is necessary to maintain the flow of venture capital. The Harvard Business School series on the effects of taxation concluded that the possibility of capital gains was an important factor in encouraging investors "to shift funds out of relatively conservative investments offering little or no opportunity for capital appreciation, and into more venturesome types of investment . . ."[22]

137. We contend the same result could be achieved by reducing personal income tax rates. A reduced upper limit, and a lower overall structure, would maintain the incentive to invest and reap income. Provision to balance capital losses against capital gains would add the incentive of knowing the government would share losses. Further, special treatment of capital gains may encourage too much speculation in risky ventures. New investment services the nation as long as there is a reasonable chance of success. Wild speculation, particularly in stock of highly risky ventures, simply interferes with the orderly flow of capital into useful channels.

138. The main argument against taxing capital gains rests on the locked-in problem. Investors are encouraged, it is argued, to hold on to securities or property in which gains have accrued, rather than selling and reinvesting. This causes investors to hold back their supply of a stock which has gained in value, to increase their capital gain, and to dump their supply in a decline, to take their capital loss. If this was true, locking-in would aggravate stock market rises and declines. But the Harvard study cited indicated the timing of investment transactions was affected by the U.S. capital gains tax by only 6 per cent.[23] If it is profitable to shift, a shift will be made, although the margin to make a shift profitable might change slightly with taxation of capital gains.

139. Locking-in, however, does not necessarily reduce the amount of new capital available for investment. An individual who sells a security for a capital gain does not create new money, he merely takes it from somebody else. The net effect depends what the new buyer would otherwise do with his money, compared with what the seller intends. If the buyer would otherwise invest in new ventures to the same extent, there would be no reduction in the flow of new venture capital.

140. Another objection is that capital gains merely reflect a general price increase. To some extent this may be true--but to the same extent there is no reason why stockholders and landholders should benefit from inflation. There is more merit to the counter-argument: Evils produced by inflation are so great that taxing capital gains arising from inflation cannot add to them and in part may offset them.

141. Similarly, it is argued that capital gains reflecting changes in the interest rate are fictitious. A person who buys a bond, then has it appreciate if interest rates drop, must invest all his gain in bonds to maintain previous interest earnings. If he is taxed on his capital gain, he could not maintain his old rate. But the investor might just as easily use his gain for consumption, in which case he would be better off.

142. We propose a method of taxing capital gains that spreads the income over the years it was earned. Thus it still represents relatively favorable treatment compared to ordinary income. We calculate it would produce at least $100 million in added personal tax revenues. (See Appendix VIII.) The tax would be calculated as follows:

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143. The first $500 of capital gain should be exempt to save administrative difficulties on small amounts and to provide incentive to small investors.

144. The remainder of the capital gain would be divided by the number of years over which it was earned. The years would be counted from the date of purchase, with any fraction counting as one year. This portion of the capital gain would be included with other income for the current year and the tax payable would be computed.

145. The amount of tax payable would next be divided by the taxable income so far determined to obtain an average rate of tax. The balance of the capital gain would be multiplied by this average rate to determine the tax payable on the balance of the capital gain. In essence, the portion of the capital gain attributable to prior years would be taxed at the average tax rate on the current year's income.

146. Total tax liability would be obtained by adding together the tax payable from each step.

147. Capital losses should be allowed as a deduction from capital gains, with unlimited carry-forward. Strict adherence to the net accretion theory would mean deduction of capital losses from income in any year they exceeded gains. It is necessary, however, to prevent large decreases in government revenues in poor years, since the level of government activity is such a key factor in maintaining the economy. Such treatment would also give undue encouragement to speculation. The U.S. restricts loss carry-forward to five years but in part this reflects the preferred treatment of capital gains.

148. It is argued that capital gains do not represent ability to pay when the individual has to replace the asset at higher price levels, such as a house. We would exempt from capital gains taxation gains (and losses) resulting from the sale of owner-occupied houses and other personal property such as

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cars or furniture. An apartment owner would be free from capital gains tax on the portion accruing from his own apartment, but would be subject to taxation on the remainder.

149. The owner-occupied exemption should apply to only one acre of land. Anything larger represents a business asset, speculation or a luxury, and should be taxed.

150. To ease the locked-in problem, assets held until death would be taken over by the heirs, for income tax purposes, at original cost. An heir who sold an asset for a capital gain would thus have a tax liability, which would leave little incentive for deliberate locking-in before death. The heir, in computing tax liability, would average from the date of original purchase.

151. For succession duty purposes, valuation of assets would be at market value but would have to include consideration of the potential income tax liability. This could include provision for refunds when the tax is paid.

152. Capital gains should be defined as investment income, which would mean the application of the 4 per cent surtax on foreign gains. This is a useful disincentive to invest outside the country and perhaps should be increased, since the pressing need is for domestic development.

CAPITAL COST ALLOWANCES

153. Capital cost allowances are the major source of business saving in Canada. The rate at which industry is allowed to replace and maintain plant and equipment is thus a key to private investment in capital goods.

154. From 1951-60, capital cost allowances provided more than 80 per cent of business saving. The sources

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(excluding inventory adjustment) were $8,100 million from undistributed income and $33,500 million from capital cost allowances. Since dividends represented half of net profits, capital cost allowances were more than double net profits. (See Appendix IX.)

155. Accelerated capital cost allowances, by lowering tax liability, are thus a potent method for increasing savings. In 1960, for instance, private investment in new assets (excluding municipal, institutional and housing) was about $4,000 million. Capital cost allowance was between $500 million and $750 million. If complete write-off of assets was allowed in the year of purchase, taxable income would have been reduced by more than $3,000 million. Since corporation profits before taxes were $3,200 million they would have been eliminated. However, the entire amount would have been available for corporate purposes as cash flow.

156. Obviously any increase in present capital cost allowances would sharply reduce government revenues. But what is claimed today cannot also be claimed tomorrow. In the long run the government receives the same revenue. The flexible instrument is when the corporation claims depreciation.

157. An increase in the capital cost allowance has two major effects:

- It provides corporations with a larger cash flow and thus with more money to invest;

- It provides more incentive to invest because of quicker recovery of capital.

158. The need to spur private investment and provide Canada with modern industry is one of the basic tenets of this submission. If accelerated depreciation is to be used two key factors must be considered:

- Every dollar added to business saving comes from immediate government revenues;

- The incentive must be to invest in desirable areas. We have defined this as areas producing Canadian jobs, goods and technology.

159. It has been suggested in some quarters that the best way to do this is to extend government loans to the particular area the government wishes to encourage. We feel that an open offer to all is politically more desirable, administratively more feasible and removes the unpalatable discretionary authority involved in a loan program. Our proposal balances what is financially feasible with the need to spur specific types of investment.

160. Of total new fixed asset investment of $8,200 million in 1960, $2,713 million was in machinery and equipment. Of this amount, nearly $1,000 million was in Class 8, depreciable at 20 per cent a year on a reducing balance. The rest included purchases by the three levels of government (not taxable); by railways and electric, water and gas utilities; by pipelines, telephone and telegraph companies and chemical pulp companies; and purchases of ships, aircraft, vehicles, etc. All are items that for depreciation purposes are in other classes.

161. We recommend a special single write-off of half the cost of new Class 8 machinery and equipment purchases be allowed in addition to the regular 20 per cent allowance.

162. We do not want this benefit extended to imported machinery and equipment unless it is used to produce exports and cannot be produced in Canada. Administratively this is difficult. We propose, therefore, that the manufacturers sales tax exemption be removed from imported machinery and equipment used in production, unless it is used to produce exports and cannot be produced in Canada. This is examined further in the sales tax section.

163. The cost of this special allowance to revenues would be 22½ per cent on applicable purchases or about $200 million in the first year, but revenues would rapidly recover in later years. By the fourth year losses would be nominal--less than 2 per cent of government revenues--and should be more than offset by increased revenue from economic growth, spurred by the added incentive to invest. (See Appendix X.) A higher rate of investment, which we would expect, would produce a quick positive effect on revenues. GNP would increase, productivity would increase and profits would increase. Certainly any revenue loss would be small compared with what will happen if the economy fails to progress.

164. The gain to industry would be in the year the special allowance was claimed, since future write-offs would be reduced. In effect, the government would grant an interest-free loan and take repayment over an extended period.

165. Assuming an interest rate of 8 per cent for business funds, the after-tax benefit would be worth nearly 4 per cent of asset cost over five years and almost 6 per cent over 10 years. If a company had to borrow at higher rates, say 1 per cent a month, the net saving would be 6 per cent after five years and 10 per cent after 10 years. To a company that could not borrow money, the gain would be almost immeasurable. (See Appendix XI.)

166. One of the main advantages to a special capital cost allowance of this type is that it puts both incentive and purchasing power in the hands of business when it is most needed. When the economy turns and counter-cyclical measures are required, the special allowance could be cancelled. This would cause a reduction in investment and increase government revenues at a time a surplus is desirable.

167. In the first year, our overall program would balance revenue gains and losses. The government would use this time to plan its social capital program. In later years, corporate tax revenues would at least return to what they would have been and our overall program would produce net gains in government revenues. These gains would finance the social capital program.

PROVINCIAL REVENUES

168. At this stage we examine the effects of certain recommendations on provincial revenues.

169. Our overall tax program would balance revenue gains and losses at a gross level, that is, before the provinces received their share of corporate and personal taxes. Since the provinces would not receive revenue from an increase in the manufacturers sales tax, an adjustment would be needed to balance the losses they would suffer in the corporate and personal fields.

170. The provincial share of personal tax revenues is 16 per cent, rising to 20 per cent by 1966. Our lower rates would decrease gross revenues by $175 million while taxation of capital gains would restore $100 million, for a net drop in gross revenues of $75 million.

171. The provincial corporation tax is 11 per cent for Ontario and Quebec, 9 per cent for the others. The special capital cost allowance would decrease gross revenues by $200 million the first year, of which the provincial share would be about $46 million. As explained previously, this loss would decrease rapidly.

172. Without any adjustment to the provinces, federal revenue gains would exceed losses because the sales tax increase would not be shared. This net gain

could be redirected to maintain provincial revenues by increasing the provinces' personal tax share. For instance, if all our recommendations were adopted this year, increasing the provincial share of personal tax revenues to 20 per cent immediately would maintain their revenues. We suggest, however, some provincial reduction would be reasonable on two grounds:

- The recommendations aim at increasing corporate profits and personal income faster than under the present structure--provincial revenues would gain accordingly;

- The federal government's social capital program would largely go to areas now pressing for provincial funds, and would ease this pressure from what it would otherwise be. Such investments in social capital have constituted a major drain on the provinces. Ontario, for instance, expects to spend one-third of its 1962-63 budget on education, three times what it spent only five years ago.

MANUFACTURERS SALES TAX

173. An increase in the manufacturers sales tax completes our proposals.

174. Increased government expenditures have largely been due to social welfare payments. This is quite proper. But once a society has attained a minimum standard of living, it is reasonable to tax consumption to provide government with revenues to meet remaining needs of social welfare and social balance. Canada's average per capita real income has risen more than 45 per cent since 1929. By any criteria we enjoy a reasonable standard of living. The sales tax thus becomes an obvious solution to the pressing need to provide incentives for desirable private investment and funds for government investment in social capital.

175. "The relation of the sales tax to the problem of social balance is admirably direct. The community is affluent in privately produced goods. It is poor in public services. The obvious solution is to tax the former to provide the latter--by making private goods more expensive, public goods are made more abundant."[24]

176. Our proposals attempt to modify this principle. Reducing personal tax rates should offset the increased cost of consumption so consumption expenditures are maintained. But we emphasize that action is required. If sacrifice is necessary, it should be in consumption for the sake of investment.

177. The manufacturers sales tax, as a method of providing the needed balance and incentive, has two great advantages:

- It presents no additional administrative difficulties, since it would involve an increase in an existing tax with which the nation has had considerable experience;
- It is politically acceptable to business, having been commended by several business groups. Granted that this has usually been done while espousing the sales tax as an alternative to other taxes, it emphasizes that the sales tax does not damage incentives or interfere with production.

178. The 11 per cent manufacturers sales tax includes 3 per cent for old age assistance. Each 1 per cent raises about $100 million. The source of sales tax revenue is 60 per cent from consumer goods, 30 per cent from industrial goods and 10 per cent from sales to government (for items such as defence).[25] Discounting government transfers, a 3 per cent increase would add $270 million in revenues.

179. The portion falling on industrial goods would be $90 million, less than 3 per cent of corporate profits. Since the tax liability would be deductible from taxable income, net cost to industry

ir public services. The obvious only [illegible]
the former to provide the latter—by [illegible]

[illegible]

the increased cost of co[illegible] [illegible]
[illegible] But [illegible]
[illegible] necessary. [illegible]
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117. The [illegible] tax, as a method of
providing [illegible] has [illegible]
great [illegible]

[illegible] increase [illegible]
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[illegible] the sale, [illegible]
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[illegible] per cent for old age assistance. [illegible]
[illegible] about $100 million [illegible]

[illegible] from industrial [illegible]
[illegible] government (for [illegible]
[illegible] government [illegible]
[illegible] $170 million [illegible]

119. The portion [illegible]
would be [illegible]

deductible [illegible] taxable income, [illegible]

would be about $45 million. A substantial portion of the tax falling on industry is believed to be shifted, but we feel it would be reasonable to expect industry to absorb any increase under our program for these reasons:

- The special capital cost allowance should spur productivity and increase business profits;

- Added government investment in social capital would aid productivity increases, for instance by providing a better-skilled labor force;

- Any tax increase should be accompanied by a government campaign to convince the nation of the need for stable prices.

180. In any case, export industries and their suppliers would remain exempt so foreign trade would not be affected.

181. The portion of the increase on consumer goods would be $180 million, or two-thirds of 1 per cent of personal income. We would assume complete shifting of this amount and thus retail price increases would be 2 per cent. Basic items like food, shelter, fuel and utilities, which make up between 63 and 70 per cent of consumer expenditures, would continue to be exempt.

182. The result, to an average taxpayer with $5,000 income, would be increased consumption costs of $37 a year and lower income taxes of $45, or an $8 increase in disposable income. The increase in disposable income would rise with larger incomes.

183. The small added burden would fall, in general, on incomes of less than $5,000. Consumption costs would increase $7 a year at $1,000 income, where there is no income tax. The maximum added cost, depending on status, would be from $20 to $25 in the brackets from $3,000 to $5,000 of income.

184. It might be argued that this structure would be regressive. We contend that the low and medium income groups do not bear a reasonable proportion of the cost of extensive government services and in particular a fair share of the growing social welfare costs. Appendix VI shows the favorable position of a Canadian taxpayer at low levels compared with U.S. and British counterparts. The added cost to this taxpayer every month would only be 60 cents to $2, not an unreasonable burden. Except at the lowest bracket, the individual could still obtain a net gain by cutting his consumption, since personal tax rates would be lower. The limited data on consumer behavior in Canada, however, suggests such a shift would be unlikely.

185. If some relief was deemed essential, exemptions could be broadened. The following items, now taxable, if exempt would make the sales tax more progressive:

- Drugs used in prescriptions and other medicines; tea, coffee and prepared beverages; margarine; cooking oils, shortening and baking soda; many prepared deserts, icing, jello and cake mixes; chocolate, olives and pickles; spices, flavorings and extracts; candy and nuts; some building materials--hardware, pipe fittings, some types of cupboards, asphalt composition.

186. Appendix VII sets out the net results on various classes of taxpayers from the proposed changes in sales and personal tax rates.

187. The net effect of our proposals would almost balance the portions of federal and provincial revenues coming from income and consumption taxes. In 1962 they will receive 47 per cent from income and 40 per cent from consumption. This would change to 45 per cent and 43 per cent respectively, of increased revenues.

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- Drugs used in prescriptions and other medicines; tea, coffee and prepared beverages; margarine, cooking oils, shortening and baking soda; soap, prepared desserts, icing, jello and cake mixes; chocolate, olives and pickles; spices, flavorings and extracts; candy and nuts; some building materials--hardware, pipe fittings, some types of cupboards, asphalt composition.

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188. We would also use the sales tax to offset the special capital cost allowance when it is applied to imported machinery and equipment not used to produce exports or that could be produced in Canada. Such imports are now exempt from sales tax if they are used directly in production.

189. We do not want to provide any added incentive to invest in such imports, but there are too many administrative difficulties involved to limit the special capital cost allowance. Making these imports liable to the sales tax would be an ample counterweight.

190. Total imports of machinery and equipment in 1960 were $1,000 million. Probably $350 million would become subject to sales tax, adding about $40 million in revenues for purposes of our program. Thus the net increase in sales tax revenues under our program, after deducting inter-government transfers, would be about $300 million.

191. All of which is respectfully submitted for your consideration.

APPENDIX I Research and Development, 1959

Total Expenditures[1]	Canada	U.S.	U.K.
Percentage of GNP	0.72	2.58	2.11
Performed by:			
Government--% GNP	0.34	0.37	0.70
Industry--% GNP	0.28	1.96	1.23
Financed by:			
Government--% GNP	0.44	1.67	1.41
Industry--% GNP	0.23	0.85	0.63

[1] University research, other private expenditures included.
Source: Financial Post, Nov. 25, 1961, p. 38.

APPENDIX II Inner Reserves

The first specific information about inner reserves came in 1954 when Hon. Douglas Abbott, Minister of Finance, filed Exhibit 31 with the House of Commons Standing Committee on Banking and Commerce. It showed that inner reserves included all unpublished reserves other than depreciation reserves on premises. These unpublished reserves included:

Tax-paid reserve: The portion on which income taxes had been paid;

Specific reserve: Specific reserves required to reduce specific assets to estimated realizable value. This reserve was tax-free.

General loss or contingency reserve: Remaining inner reserves came within this classification, and were also tax-free. The reserve was limited, however, to certain percentages of various bank assets--2% of other than short-term securities of the Canadian, U.S. or U.K. governments, 3% of provincial securities and 5% of loans, letters of credit, net foreign exchange position and other investments.

The exhibit revealed for the first time the permitted maximum of general reserve for all banks; at the 1953 year-ends it was $319.7 million. It was also learned that no individual bank was at its permitted maximum, although some had reached the limit in recent years. The Royal Bank reported at its 1954 year-end that its tax-free inner reserves were at the maximum allowed.

The $319.7 million, it must be noted, did not include specific or tax-paid inner reserves.

Changes have been made since 1954 in the method used to calculate allowable tax-free inner reserves. While the government does not share the information with the public, it is believed the present limit is just under 5% of related assets and covers both specific and general reserves. We understand reserves are no longer permitted against federal and provincial securities.

In recent years all banks have made transfers from inner reserves to shareholders' equity on which taxes were paid. At least three of the five major banks also made transfers from tax-paid reserves. It is reasonable to assume the banks would not have transferred reserves involving tax liability unless the tax-free inner reserves were at or near the maximum. Excluding federal and provincial securities the applicable assets grew from about $5,000 million in 1953 to more than $8,500 million in 1960. This would indicate the permitted maximum of tax-free inner reserves would exceed $400 million.

We tested this computation of tax-free inner reserves in two ways:

- We compared actual tax payments since 1953 with declared net profits and transfers in and out of reserve accounts as reported by the Bank of Canada;

- We took the 1953 maximum and adjusted it for the estimated specific reserve and for transfers in and out of inner reserves in succeeding years. Actual losses, using the reported 15- and 25-year averages, were deducted. Individual bank annual reports assisted the analysis.

We assume the 1953 level--including specific reserves--was between $325-350 million. Subsequent transfers to inner reserves have exceeded transfers out of inner reserves, excluding transfers from tax-paid reserves, and actual losses. Thus we estimate tax-free inner reserves at from $350-400 million. If only three times the average annual loss experience or specific reserves was allowed tax-exempt status, at least $300 million would thus be taxable.

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APPENDIX III Operating Statistics, Chartered Banks

	Average 15 years 1929-43	Average 7 years 1944-50	Average 10 years 1951-60
	(millions of dollars)		
Operating earnings and capital profits	141.2	221.7	530.9
Less operating expenses	101.8	169.1	409.1
	39.4	52.6	121.8
Less income tax provisions	10.5	14.2	49.4
	28.9	38.4	72.4
Less gross provision for inner reserves	14.5	20.3	30.7
Net profits reported by banks	14.4	18.1	41.7
Add excess provisions inner reserves over estimated net losses[1]	.7	15.3	20.0
Net profit after adjustment	15.1	33.4	61.7
Dividends paid	13.6	13.1	31.3
Increase shareholders equity (excluding new financing)			
Profits less dividends	.8	5.0	10.4
Retransfers inner reserves	---	4.6	14.8
Ratios to declared shareholders equity			
Net profits reported	4.9%	5.5%	6.8%
Net profits reported plus retransfer inner reserves		6.9%	9.3%
Net profits adjusted	5.1%	10.1%	10.1%
Dividends	4.6%	4.0%	5.1%

APPENDIX IIIA

	1956	1957	1958	1959	1960
Oper earnings & cap prof	516.6	608.9	674.9	750.1	846.1
Less operating expenses	399.8	484.2	519.9	584.8	645.9
	116.8	124.7	155.0	165.3	200.2
Less income taxes	41.7	56.6	69.6	65.2	90.7
	75.1	68.1	85.4	100.1	109.5
Less provision for inner reserves	33.1	21.5	32.8	40.8	40.9
Net profit reported	42.0	46.6	52.6	59.3	68.6
Add excess inner reserves[1]	21.5	9.5	20.0	28.0	27.9
Net profit after adjust.	63.5	56.1	72.6	87.3	96.5
Dividends paid	31.9	35.4	40.0	47.6	54.0
Increase shareholders equity					
Profits less dividends	10.1	11.2	12.6	11.7	14.6
Retrans. inner reserves	19.0	18.7	16.8	8.5	15.7
Ratios to share. equity					
Net profits reported	6.9%	6.6%	6.8%	6.8%	7.1%
Profits reported plus retransfers	10.0%	9.3%	9.0%	7.8%	8.7%
Net profits adjusted	10.4%	8.0%	9.4%	10.0%	10.0%
Dividends	5.2%	5.1%	5.2%	5.5%	5.6%

Source: Bank of Canada, Statistical Summary.

[1] Our estimate; see Appendix II.

APPENDIX IV Return on Net Worth

	No.	1960	1959	1958
		Percentages		
Metals	6	13.13	11.87	7.77
Lumber	4	10.03	10.16	5.35
BANKS		10.0	10.0	9.4
Milling & grain	8	9.58	9.42	6.92
Pulp & paper	17	9.37	9.19	9.04
Miscellaneous	64	9.32	10.05	9.37
Foods	17	9.15	9.38	8.82
Beverages	9	8.91	8.90	8.74
Merchandising	26	8.14	9.40	10.07
Oils	17	8.10	7.07	6.71
PUBLIC UTILITIES	28	7.42	7.29	6.31
Construction	18	7.06	8.68	10.35
Textiles	27	6.59	6.69	5.53
Iron and steel	65	6.48	9.38	7.97
Transportation	7	3.03	3.31	3.47
Avg (except banks)		7.99	8.33	7.28

Source: Financial Post, May 13, 1961, p. 32.

APPENDIX V Personal Income Tax Rates

Present rates[1]			Proposed rates[1]			Reduction	
Lower limit	Tax on lower limit	Rate on excess	Lower limit	Tax on lower limit	Rate on excess	$[2]	%[3]
0	--	14%	0	--	14%	--	--
1,000	140	17				--	--
			1,000	140	15		
2,000	310	20				20	7
			3,000	440	17		
3,000	510	19				70	14
4,000	700	22				90	13
			5,000	780	20		
6,000	1,140	26				160	14
8,000	1,660	30				280	17
			8,000	1,380	25		
10,000	2,260	35				380	17
12,000	2,960	40	12,000	2,380	30	580	20
15,000	4,160	45	15,000	3,280	35	880	21
25,000	8,660	50				1,880	22
			25,000	6,780	40		
40,000	16,160	55				3,380	21
			50,000	16,780	45		
60,000	27,160	60				5,880	21½
			75,000	28,030	50		
90,000	45,160	65				9,630	21
			100,000	40,530	55		
125,000	67,910	70				13,630	20
225,000	137,910	75	125,000	54,280	60	23,630	17
400,000	269,160	80				48,880	18½

[1] Rates include old age security tax of 3% on the first $3,000 of taxable income.

[2] Reduction in dollars is based on the lower limit in the first column.

[3] Reduction in dollars as percentage of tax at present rates.

APPENDIX VI Income Tax Burdens

Annual salary	Single: Canada	Single: U.S.	Single: U.K.	Married (Surplus): Canada Gross	Married (Surplus): Canada Net[1]	Married (Surplus): U.S.	Married (Surplus): U.K.
1,000	--	40	51	--	(168)	--	--
2,000	88	200	271	--	(168)	--	6
3,000	208	360	571	22	(146)	--	180
4,000	352	532	873	124	(44)	160	462
5,000	515	708	1,175	250	82	320	925
6,000	698	892	1,477	403	235	480	1,065
8,000	1,102	1,308	2,370	764	596	800	1,754
10,000	1,570	1,780	3,155	1,180	1,012	1,152	2,603

[1] After family allowance payments of $168.

Note: Married taxpayer has two children; all taxpayers have medical expenses and donations of 10% of income; U.S. taxpayers have additional deductible expense of 10% of income; exchange rate of $100 for £33 compensates for the U.K. national health plan; old age security tax is excluded from Canadian tax, because U.S. and U.K. gather revenue for similar programs separately.

APPENDIX VII Sales Tax--Income Tax Balance

Family income group	Percentage of income: Major taxable items [1]	Percentage of income: Taxable goods[2]	Percentage of income: Burden of 3% increase[3]	Sales tax burden, lower limit	Income tax decrease, lower limit[4]
Under 1,051	24.9	29.5	.62	$--	$--
1,051-1,549	30.9	35.4	.74	7	--
1,550-2,050	29.9	32.8	.69	11	--
2,051-2,549	31.0	33.8	.71	14	--
2,550-3,050	33.8	36.9	.77	19	--
3,051-3,549	33.6	37.2	.78	23	1
3,550-4,050	34.3	37.4	.79	28	11
4,051-5,050	33.0	36.6	.77	31	23
5,051-7,499	33.0)	32.0	.67	38	71
Over 7,500	24.4)			48	150

[1] Includes major consumer items only. (See House of Commons Debates, 1951.)

[2] Includes all taxable items but does not include universal pyramiding. (See John F. Due, The General Manufacturers Sales Tax in Canada.)

[3] Assumes complete shifting of tax and that 3% at manufacturers' level equals 2% at retail level. (See Due.)

[4] Assumes $2,000 in exemptions.

Note: Percentage of family income spent on items subject to manufacturers sales tax is based on the Dominion Bureau of Statistics 1947-48 survey. Table assumes a 3% increase in sales tax, personal tax rates according to those proposed in Appendix V.

APPENDIX VIII Capital Gains--U.S. Revenues

	1959	1958	1957	1956
	(millions)			
Personal returns with reported capital gains	4.0	3.5	2.9	3.15
Net capital gains[1]	6,797	4,879	4,128	4,991
Losses allowed[2]	520	550	640	440
Tax status of net gains:				
Non-taxable	680		400	
Normal tax	4,050		2,500	
Alternative tax[3]	2,050		1,240	

[1] After deduction of losses from gains.

[2] Losses claimed as deduction from ordinary income because they exceeded capital gains in the year. The U.S. limits this deduction to $1,000 and only allows loss carry-forward for five years.

[3] The effective tax on capital gains is limited to 25%.

Source: U.S. Treasury Department, Statistical Study of Income, Individual Income Tax Returns, 1955-59.

Note: In 1959 U.S. revenues from taxation of capital gains were more than $2,000 million. To obtain our estimate of Canadian capital gains we adjusted for the relative sizes of the economies, for unlimited loss carry-forward, for valuation of estate assets at original cost (U.S. values estate assets at market and does not tax the estate on capital gains), and for the fact that many property sales in the U.S. treated as capital gains would already be taxed in Canada as ordinary income. We also allowed for more conservative investment tendencies by Canadians.

APPENDIX IX Sources of Business Saving

	GNP in current $ (mill)	Per capita 1949 $	C.E. (mill)	C.E. % GNP	P.E. % CE	Business saving (mill) U.I.	CCA
1951	21,170	1,324	4,739	22.4	48.2	662	2,203
2	23,995	1,385	5,491	22.9	48.9	618	2,422
3	25,020	1,401	5,976	23.9	49.7	729	2,673
4	24,871	1,320	5,721	23.0	52.4	571	2,905
5	27,132	1,396	6,244	23.0	51.6	962	3,266
6	30,585	1,481	8,034	26.3	48.8	1,131	3,642
7	31,773	1,437	8,717	27.4	48.3	854	4,009
8	32,600	1,414	8,364	25.7	56.0	812	3,930
9	34,593	1,426	8,417	24.3	54.1	923	4,143
1960	36,000	1,425	8,200	22.8	52.2	824	4,291

Source: Bank of Canada, Statistical Summary.

Note: C.E. - capital expenditures; P.E. - public expenditures; U.I. - undistributed income; CCA - capital cost allowance. Institutions and housing are included in public expenditure. Inventory adjustments are excluded.

APPENDIX X Special Capital Cost Allowance
Effects on Government Revenues

Year	Corporate Class 8 expends.	CCA now	New CCA	Increase or decrease	Change to government Annual	Change to government Actual (Mill)
	(Asset purchased in first year)					
1	100.0	20.0	70.0	+ 50.0	- 22.5	- 203
2	--	16.0	6.0	- 10.0	+ 4.5	+ 41
3	--	12.8	4.8	- 8.0	+ 3.6	+ 32
4	--	10.2	3.8	- 6.4	+ 2.9	+ 26
5	--	8.2	3.1	- 5.1	+ 2.3	+ 21
Balance or total	100.0	67.2	87.7	+ 20.5	- 9.2	- 83
	(Assets purchased every year)					
1	100	20	70	+ 50	- 22.5	- 203
2	100	36	76	+ 40	- 18.0	- 162
3	100	49	81	+ 32	- 14.4	- 130
4	100	59	85	+ 26	- 11.7	- 105
5	100	67	88	+ 21	- 9.4	- 85
6	100	74	90	+ 16	- 7.2	- 65
7	100	79	92	+ 13	- 5.8	- 52
8	100	83	94	+ 11	- 4.9	- 44
9	100	87	95	+ 8	- 3.6	- 32
10	100	89	96	+ 7	- 3.1	- 28
Balance or total	1,000	643	867	+ 224	- 100.6	- 906

Note: CCA - capital allowance. Actual cost assumes $900 million of expenditures and average tax rate of 45%.

APPENDIX XI Special Capital Cost Allowance
Benefit to Industry

Year	Present UCC	Present CCA	Proposed UCC	Proposed CCA	Net chg	O/S[1]	Benefit[2] Annl	Benefit[2] Cum.
1	1,000	200	1,000	700	+ 500	250	10	1.0
2	800	160	300	60	- 100	210	8	1.8
3	640	128	240	48	- 80	178	7	2.5
4	512	102	192	38	- 64	153	6	3.1
5	410	82	154	31	- 51	134	6	3.7
6	328	66	123	25	- 41	119	5	4.2
7	262	52	98	20	- 32	108	4	4.6
8	210	42	78	16	- 26	99	4	5.0
9	168	34	62	12	- 22	92	4	5.4
10	134	27	50	10	- 17	87	3	5.7
Balance or total	107	893	40	960	+ 67	90	57	5.7

Note: UCC - unclaimed capital cost; CCA - capital cost allowance.

[1] Amount of "interest-free loan" outstanding, assuming 50% tax rate.

[2] Value of after-tax interest at 4%, annually and cumulatively as percentage of investment.

NOTES

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13 Revision, 1944, p. 441.

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20 See L.H. Seltzer, The Nature and Treatment of Capital Gains, National Bureau of Economic Research, New York, 1951, ch. x.

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22 J.K. Butters, L.E. Thompson and L.L. Bollinger, Effects of Taxation on Investment by Individuals, Harvard Graduate School of Business Administration, Boston, 1953, p. 42.

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SUBMISSION

TO THE

CANADIAN ROYAL COMMISSION ON BANKING AND FINANCE

MARCH, 1962

By: A. H. CAMERON

INTRODUCTION

GENERAL REMARKS AND RECOMMENDATIONS

(1) This submission is not a comprehensive review of the financial system, but concentrates on the Bank of Canada, the Finance Department and the Bond market. My experience has primarily been in the government bond market, which has lead to some familiarity with commercial and central banking, capital flows and foreign exchange. I have been fortunate in acquiring some knowledge of the mechanism and personalities, and philosophy, of the United States Treasury, Federal Reserve Board, and U.S. bond market, and have also been privileged to visit half a dozen other central banks. Thus, in looking at our situation, I would make comparisons with the mechanism and philosophies extant in other countries.

(2) Most of the recommendations to follow are not new, for I have made them piecemeal over the past five years or so. They are my own views, and do not purport to be, except by coincidence, those of the investment industry.

---

(3) I believe that Canada suffers from maladjustments in its financial system, perhaps new to us, differing in detail but perhaps not in basic cause from those experienced elsewhere at other times.

(4) Fundamentally I blame the Keynesian idea that full employment can be restored by tinkering with the monetary system and through large government deficits, during times of higher than desirable unemployment.(F) I believe that this is proving increasingly difficult, after the wartime monetary expansion, the postwar rise in prices, the burgeoning of large scale production capabilities elsewhere, and a growing general realization that democratic governments indulge in actions which cause long-run deterioration in the value of money.

(5) Someone should enunciate a "Gresham's Law of Politicians", to wit that "those who would make money bad tend to drive out those who would make it less bad". It has become a political credo that to secure and retain office it is necessary to increase public spending, taking a larger and larger share of Gross National Product through taxation (and more through watering the money supply), distributing more and more to the voters at large.(F) This modern interpretation of the Marxist "From each according to his abilities, to each according to his needs", is practiced by many political parties which shun the Marxist label.

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(6) I believe Canada is passing through such a stage, which will last until people fear it may destroy the system which once gave us the world's second highest living standard, for many democracies have decayed this way before. Maybe the competition from other countries, such as the Common Market members, which earlier experienced the something-for-nothing, wasting currency disease, will shock us in time.[F] Maybe the cold bath will be a flight of capital, or a breakdown in the financial system, forcing the state to show its true colors -- not the benevolent welfare state but rather a regimented savings program.[F]

(7) Our financial system grew in the image of England, during the British century of stable or declining prices, sound money, the Gold Standard, and low taxes. After nearly fifty years of wasting money, two world wars, growing taxation, and the increasing political power of both the debtor class and those who would grasp the public teat, the system is showing a few cracks.

(8) These cracks, present for years perhaps, were concealed during the last War by a single minded concentration on Victory, by the rationing of goods, because inflation was concealed or soft-pedalled, because nervous investors were promised pegged bond prices, because the private sector's demands for money were small. The lender felt a community of interest with the borrower (the Government), forgetting the obvious, that the interests of savers or lenders and those of borrowers usually differ. In the early post-war years governmental surpluses, plus the willingness of Central Banks to buy in bonds at par, accommodated public dis-investment and provided the dis-investor in Government issues with the money to invest in the private sector. After 1950, government bonds began to sell at discounts, while those whose prime need was liquidity discovered that in practice it was not provided by long bonds which could sell at ten point losses.

(9) When these new attitudes had become established, we began in 1957 a new era of deficit finance, involving substantial monetary expansion. The public, after losing half the buying power of money in one generation,[F] became reluctant to buy long term government paper; bond price declines (from tight money periods) disorganized markets further, and the cracks in the financial structure appeared. The Conversion Loan of 1958 revealed many of them, and must be continually cited.

(10) I am critical of the shortcomings revealed, many of them the result of conflicts of interest within the Central Bank and the financial mechanism,

but these are not the causes of the disease. The cause, I believe, is the tendency of government to encroach on our lives as both Robin Hood and Santa Claus, to water the money supply, and to stifle the free market system when it serves them poorly, by jerry-built, ad hoc, piecemeal attempts to direct investment, with unsuspected consequences in other areas.

(11) I believe the Bank of Canada has tended to regard the bond market as a utensil created primarily for the benefit of themselves and the Government. They have manipulated it, when it suited their purpose, even on one occasion effectively capturing it for two months, and they have become the dominant factor, as principal and government agent directly, and through their pressures on dealers and banks indirectly. Markets so dominated by one participant tend to atrophy, eventually serving the dominant participant poorly as they lose appeal to other participants. From the many activities of the Bank, in regulating money supply, marketing government issues, investing Trust Funds, making rules for the "money market", regulating banks through moral suasion, I sense that their concept of a free market differs from that of most institutional and individual investors. I do not get this feeling in the Federal Reserve Board of the United States which met many similar problems without the same yen to dominate and manipulate the market.

(12) My recommendations are but repairs which may enable the financial system to function more satisfactorily until Governments change their ways, either by ceasing to do more and more for the people, or by outright regimentation. These changes may occur through a public awakening, through inflationary pressures ending in a deflation as high priced export goods cease to sell, while domestic industries are idled by cheaper imports.

(13) These repairs are more necessary now than in previous, earlier eras. In particular I would reduce the grip of the Bank of Canada on government finance and on the bond market, so that the market might function more freely, with less official pressure, or influence.

I would group these recommendations:

(14) BANK OF CANADA

1. The Bank Board should consist of a few almost full time persons, possessing a working knowledge of finance and economics, capable of giving the Governor expert advice.
2. The Bank of Canada Act should specify the Governor's tenure, pension, grounds for removal, etc.

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3. The Act should also state that the Bank's policy is that of the Government, with the Government being responsible for such policy to Parliament.

4. The Bank merits increased powers over banks and other areas of finance, but these should be specified as to area in the Act, and the Bank's right to acquire additional power extra-legally, through pressure or moral suasion, should be severely curtailed.

5. The access by Bank of Canada to information in the hands of the Inspector General of Banks should be with the proviso that there should be no conflict with Section 67 of the Bank Act (the secrecy provision), nor should the Bank of Canada use information so obtained to discriminate against any chartered bank or customer.

6. "Money Market" should be formally recognized in the Act, open to all security dealers on a voluntary, even occasional, basis, with specified margin requirements, and no opportunity for discrimination, or the control of dealers' inventory items.

7. Bank of Canada should be permitted to replace bills (or run them off) at the weekly auction, but not to add to its holdings beyond this replacement except through the open market.

8. The Bank should be audited by the Auditor General, so that the record will show discriminatory deals, or any use of funds contrary to public interest.

9. The Governor's Annual Report should be examined and discussed every year by Parliament or a Committee thereof.

10. The Bank should again be obliged to arbitrarily set a Bank Rate.

11. The conflict of interest, inherent in having monetary policy and debt management functions concentrated in the Bank, should be minimized by diminishing the Bank's influence in the debt management area, and by restricting the Bank's monetary policy open market operations to short term issues.

12. The triple conflict of interest of having the Bank (or Finance) represented on the investment committees of Trust Funds should be eliminated.

13. Any present or future "agreements" between Bank of Canada and chartered banks, or anyone else, should be examined by Parliament, and either legalized or voided, and these should never be kept secret even during the period of negotiation, for secrecy can harm those kept in ignorance of the negotiations.

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THE FINANCE DEPARTMENT

(15) 1. The Minister of Finance's job should be split, to reduce his responsibilities in some areas, and so that he will be able to devote more time to the public debt. Perhaps there should be an additional Deputy Minister, who could concentrate on debt matters.

2. The Finance Department should have a well-staffed Debt Management Division, to research for and to carry out the advice of, a Public Debt Commission, to be appointed outside civil service salary scales. There should be a marketing expert in the Division or on the Public Debt Commission.

3. A "Target" deficit or surplus should be a feature of every Speech from the Throne, with the details coming later in the regular budget.

THE BOND MARKET

(16) 1. The "Money Market" should be specifically legalized, opened up, and freed from any undue influence asserted by Bank of Canada. The establishment of margin requirements, and the non-discriminatory accommodation of dealers should be enough, without the Bank having any power to suggest the composition of inventories. (This duplicates suggestion #5 re Bank of Canada).

2. The Long term bond market should be given a chance at rehabilitation, by freeing it from the bear-hug of official influence. (Mainly the Bank of Canada, in one guise or another). The Bank's dealings in the market should be restricted to money market issues, while Government Trust Funds should not deal in market issues, or should have Boards free from Bank or Finance influence. Let the Bank cease being the underwriter, and re-seller of new government issues.

3. Government bond issues should be offered at a net price to all comers, without commission, with perhaps guaranteed full allotment to small investors, and a publicly announced flat percentage allotment to others such as banks, institutions and dealers. This should free dealers from the conflict of interest inherent in possessing a certain unwritten but predictable allotment of any new issue, during the Bank's pleasure. The conflict of interest is that, while in a preferred position on the Bank list, dealers may view themselves as primarily government agents, to the detriment of the interests of investors.

4. The Commission should consider the growing share of the National debt represented by Savings bonds. This poses a redemption threat, which I believe should be welcomed, not deplored, since it gives investors a

collective power of discipline over government, just as demand deposits encourage rectitude among bankers.

5. Insurance companies should be able to trade Canada issues for other Canada issues, adding on to the price of the purchase any "book loss" they must incur by selling the original investment, rather than being obliged to charge the loss to current year's earnings. This would broaden the market, and permit investment judgment to predominate over book-keeping considerations.

FOOTNOTES.

In addition to certain appendix material, I have added a number of footnotes, which will bear numbers corresponding to those of the paragraphs to which they refer. Instead of these being at the foot of each page, they will be grouped at the end.

A. H. CAMERON.

MAIN BRIEF

1.

THE BANK OF CANADA

BOARD OF DIRECTORS

(18) Arguments that the Bank of Canada Board (meeting infrequently, dominated by the Governor's veto power) possessed little authority, were summarized in the February, 1961 Journal of the Canadian Political Science Association by Professor Scott Gordon of Carleton University (See pages 11-12 in attached reprint). Though most of the Board's history supports this contention, the events of 1961 show that the Board could also be the creature of the Finance Minister, in endeavoring to obtain the Governor's resignation.

(19) Either subservient condition questions the utility of the Board as presently appointed. There is little indication that the Board could ever brake the Governor, without the aid of the Minister, nor did it serve the Minister in securing the Governor's resignation, without the aid of a bill in both Houses, plus a Senate enquiry.

(20) Since 1936 a few directors, notably J. T. Bryden, and the late Edgar Tarr, Peter McQueen and Thomas Bradshaw, were well qualified by experience and background to give the Governor useful financial advice, but geography and political background seemed to govern most appointments. I suspect that infrequent Board meetings may have seen the Governor give the Board his views on the economy, rather than the reverse.

(21) I believe a Board meeting in the Maritimes coincided with the planning of the ill-fated 1958 Conversion Loan, the largest financial operation in years. If the Commission ascertained from the Board's minutes whether the Board were told of this coming program, and if so, whether it tendered any advice, the Commission might determine what value the Governor placed upon the Board's advice. The Bank records should show the date of the meeting, and if the printing orders, etc. were coincident.

(22) Further, Governors might derive real aid and advice from a small Board, perhaps four or five people available in Ottawa two or more days per week -- people with practical backgrounds in finance and economics, even if we must junk the geographical representation principle, plus the ban on bankers which may now bar our most knowledgeable money-men.

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Board of Directors - continued

(23) Such advisers might aid a Governor on technical matters, restrain him from pursuing moral suasion too far beyond his legal powers, or from trespassing into fields of public policy reserved to Government or Parliament, yet buttress the Governor against unwise policies advocated by economically uninformed Ministers by showing that the Governor had the backing of the financial community. (F)

(24) Such a Board could also explain Bank Policy. There is suspicion in financial and business circles of government institutions directed exclusively by professional public servants lacking practical business, economic, financial or psychological experience. Spokesmen with acknowledged competence in the business and academic world could improve the Bank's image and public confidence in its policies.

(25) Members of the Federal Reserve Board in Washington, (14 year terms, $20,000 salary) are not dominated by the Chairman (4 year term, extra stipend $500), and these full-time Board members frequently expound Board policy, visiting the twelve districts to supplement the (usually twice a year) visits of the Chairman.

(26) As a visitor to many American banks and dealers, I can say that the usually frank critiques of the Administration or Treasury seldom are augmented by criticism of the "Fed" or its Board members. Possibly one explanation is the smaller debt management role of the "Fed", compared to Bank of Canada, plus the "Fed's" adherence to its legal powers with little reliance on moral suasion, compared to Bank of Canada. Yet, in London, where the Bank of England has both a large finger in debt management, and employs moral suasion extensively, but has many respected "City" people on its Court, criticism of the Bank in the "City" is rather small.

(27) Though shunning popularity contests, Central Banks merit the respect and confidence of the private financial sector, to which a proper Board would contribute. Such goodwill existed long after the War, even with the present type of Board, perhaps due to memories of wartime collaboration on War Finance, but more likely due to the personality, wide experience, and universal respect enjoyed by Mr. Towers, whose "feel and flair" may have concealed many structural flaws more evident under more mechanistic management in recent years. (F)

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THE GOVERNOR

(28) The past year's events indicate beyond question that Parliament should by legislation clarify the position of the Governor as to tenure, grounds for dismissal, and pension.

RESPONSIBILITY TO GOVERNMENT

(29) Obviously Government cannot long escape responsibility for Bank policy, but for varying periods Ministers have disowned unpopular policies, while seldom hesitating to take bows for popular Bank moves. I believe some Central Bank Acts specify that the Bank's policy must be that of the Government, for which Government is responsible, thus hindering Ministers who would play Pontius Pilate in Parliament.[F] I hope the Commission will suggest such an amendment to the Bank of Canada Act.

GENERAL POWERS of BANK and/or GOVERNOR

(30) Many people, including a former Governor, believe that the Bank's powers over banks, finance companies, and other institutions should be enlarged. Whatever these changes may be, I think they should be covered by specific legislation, so Parliament and/or its committees can hear witnesses, discuss the matter, and enact the changes, making sure the powers are to be used openly.[F]

(31) The Bank obtained "agreements" from chartered banks, not specifically blessed by the Act, notably those respecting secondary reserves and term loans, with no one certain whether the Bank's arguments, or the fear of the Bank's legal right to raise cash ratios, etc., tipped the scales. When the banks began augmenting secondary reserves by switching for bills, the bond market learned, after a costly period of secrecy, what was on foot through a bank "leak". Monetary policy was being made in secret.

(32) Other attempts to make changes without legal authority were less successful, notably suggestions anent notional segregation of savings deposits, and suggestions made to finance companies (though chartered bank credit lines for finance companies were frozen). Perhaps other sectors of the economy incurred official displeasure, with the Bank acting in the public interest -- as it saw it -- but without specific authority, to allocate resources (credit being the ration coupons) between different classes of borrower. Similarly limits on term lending may have penalized one company lacking other sources of funds, as against another with additional, perhaps non-Canadian, facilities.

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General Powers of Bank and/or Governor - continued

(33) Though the Combines Act exempts Finance, such joint actions by Bank of Canada and satellite chartered banks are a de facto restraint of finance. If this be deemed in the public interest, surely legislation should spell out how, when and where, at least as to area, though I would not want to see rigid formulae in the Act. I hope the Commission can examine the place of term loans, notional segregation of savings, regulation of finance companies, etc., and reject or recommend appropriate legislation. I think the term loan has a valuable service to perform for a customer where the banker can accommodate him better than alternative finance.[F] If at times it is an expansionary force to money supply it is no more so, and perhaps more productive than a government deficit or N.H.A. mortgage.

(34) The Inspector General has access to chartered bank books, the purpose being stated (in Section 63 of the Bank Act) as being primarily for the protection of creditors and shareholders of a bank. Notwithstanding Section 67, (respecting secrecy) the Minister, Deputy, Bank of Canada Governor or his representative, appointed in writing, has access to any information regarding the affairs of a bank.

(35) When Parliament creates a right of enquiry for one purpose - i.e. protection of depositors and shareholders, should not parliament make sure it is not used for other purposes, such as the allocation by Bank of Canada of credit as between different customers of banks, or different industries, or in any way to discriminate against any chartered bank or customer thereof. There should be some safeguard in this regard.

(36) Financial institutions, trustees of others' funds, conduct business with prime regard to their trust funds, and some regard for their shareholders. Where the "public interest" is not defined by Parliament, such institutions will naturally do as prudence dictates, loathe to heed interpretations of "public interest" defined solely by Bank of Canada, in areas where the Bank lacks legal power. Our American friends long ago preferred a government of laws to one of men, and the Federal Reserve does little without legal authority.

(37) The 1958 Conversion Loan involved considerable pressure on financial institutions, many of whom felt that Conversion of their Victory bonds was against their best interests. The Banks nominally were in the most vulnerable position.

General Powers of Bank and/or Governor - continued

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General Powers of Bank and/or Governor - continued

(38) Though Mr. Fleming told the House (Hansard, August 29, 1958, page 4278), "The terms of the loan were clearly laid down at the beginning and there has been strict insistence on adherence to those terms", some banks may have exchanged some Victory bonds for more suitable (but not Conversion Loan) bonds, which originally emanated from Bank of Canada's own portfolio. Since all large investors were on an "exempt" list, with participating dealers barred from trading Victory or Conversion bonds with these names, except as designated by and for "The Committee", the "free bond market" was effectively closed to sizeable dealing during the Loan. Bank of Canada published a price list on Canada issues, including well marked-up prices for Victory issues. A "secondary marketing committee" of dealers was trading in the Bank, with Bank funds. The "market", to all intents, existed only in the Bank of Canada during the Loan, in such volume and at such level as the Bank and its "dealer committee" decreed. See Appendix III.

(39) I re-launder this old linen to forestall the excuse that any large special deals must have been executed "through the market". The market was the Bank, or its agents. Only a detailed audit of the Bank and chartered banks' books would show the extent and truth of widespread rumors of special deals.

(40) The point of mentioning special deals, differing from the official Conversion, is that they represent another exercise of discriminatory, discretionary power, not within the ken of Parliament, and unknown to the average investor, offered only the official deal. Since current deficits and growing short term debt presage another Conversion in a year or so, I think the Bank's power to apply pressure, or to do special deals, should be sanctioned or prohibited by law, as Parliament shall decide.

(41) I would hope Parliament would prohibit these practices, but in any event the 1958 situation cast no credit on the ethical concepts of a public institution.

MONEY MARKET WITHOUT SPECIFIC LEGAL BASIS

(42) The Bank of Canada may make loans to banks, provinces and the Federal Government (but not dealers) under Section 18, Subsection 1, paragraphs h, i and j of the Bank of Canada Act. Paragraph k permits the

Bank to buy and sell securities from or to any person, in categories which may be summarized as Canadas, Provincials, U.S. and U.K. governments, and certain commercial paper.

(43) I think that the "money market", i.e., the execution of purchase and resale agreements with certain dealers, rests only on the authority of paragraph k, with the Bank interpreting "any person" to mean only those dealers whom it accepts and who abide by the criteria, and regulations, which the Bank may from time to time lay down. In effect these dealers are privileged, during "good behavior" as the Bank defines it.

(44) Paragraph k, though broad enough to permit the Bank to do re-purchases with "any person", gives the Bank opportunities to use re-discount privileges to secure dealer cooperation, or acquiescence in many areas, including portfolio composition.

(45) It would, I think, be wise if Parliament formally put the "money market" in the Bank of Canada Act, with a known and specified set of regulations, so that "any person", or "any dealer" (if this is what the Act means) should have access to the Bank on known terms, against specified collateral with specified margin, and so no one enjoys discriminatory or discretionary power.

(46) The banks know how and when they can borrow, from the Act. Should not the "money market", with "common law" status, not be recognized, de jure, as well?

(47) In the United States the Federal Reserve Banks can, at auction, run off bills in portfolio, or replace them with <u>the same amount</u>, but if they wish to acquire additional bills, they must buy in the open market after the auction. Such a rule might be desirable here to make more Central Bank net buying of bills take place in the open, and not through an unduly high bid designed to influence the average price and yield.

<u>ACCOUNTS AND GOVERNOR'S REPORT</u>

(48) Parliament should by statute receive and discuss, in Committee or full session, the Bank Governor's annual report, for the lack of such examination for some years may have contributed to the events of 1961.

(49) Professor Gordon (CPSA Journal Reprint, February, 1961, page 13) claims that the Bank's rights to publish what it pleases, and to spend its independent income as it pleases, constitute weapons of great power. Gordon's book (The Economists versus Bank of Canada, Ryerson, Toronto, 1961),

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Accounts and Governor's Report - continued

also suggests that the Bank could hire public relations men "to put an effective gloss on the public statements and speeches of its officials.... to create a favorable image of the Bank" (page 7). These remarks, seemingly facetious when written, assume more importance in the light of the press releases from the Bank this past summer.

(50) Gordon further feels the Auditor General should be the Bank auditor, and remarks (CPSA Journal Reprint, February, 1961, page 22),

> "If we assume however that the Bank of Canada as it is now constituted never makes deals of a questionable nature, we may be assuming too much. If the Bank of Canada were to engage in such a transaction, it would probably never see the light of day. But if....the Auditor General were designated as the Bank's auditor....any irregularities of this nature would find their way into the Auditor-General's report, and would thus be opened to the scrutiny of Parliament and the general public. The independence of the Bank of Canada from the Auditor General does not guarantee the integrity or impartiality of the Bank's practices nearly as much as it guarantees their secrecy....."

(51) I would support Gordon's contention, citing the Conversion Loan.

BANK RATE

(52) In most countries the Central Bank sets a Bank or re-discount rate of interest, at which it will, as lender of last resort, accommodate banks, or dealers on short government or even commercial paper. Bank Rate is the traditional U.K. signal of official opinion on interest rates.

(53) It was so in Canada, until, in late 1956, the Bank set Bank Rate at 0.25% above the yield of the weekly auction of 91 day Treasury bills, a rate which the Bank could influence crudely by its own bids for bills, and through loosening or squeezing the chartered banks cash positions.

(54) The original motive for "floating" the rate may have been to end the criticism which arose several times in 1956 when Bank Rate was raised. The "floating rate" took Bank Rate off "page one", returning it to an obscure corner of the financial page. The Bank (or government) were no longer responsible for rising rates; one could now blame U.S. rates, or "the market"!!

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(56) I agree that a violently fluctuating Bank Rate, for example the floating rate, gives confusing week-to-week signals of Bank policy. In Canada we do not have the "open mouth policy", such as the "Fed" employs, to supplement the discount rate, for hardly a week passes in the U.S. without some public appearance by a Board member, giving the Board's views.

(57) Variations in chartered bank cash, sometimes seasonal, sometimes from erroneous projections (quickly reversed the next week) sometimes from bad weather raising the volume of items in transit, also do not correctly indicate Bank policy. These errors are more unsettling when the chartered banks are kept on a tight rein by technicians who aim at a sort of push-button system where close linkage provides immediate bank reserve reaction to Central Bank action, for there is little cushion available.

<u>CONFLICTS OF INTEREST</u>

(58) The Bank of Canada buys and sells securities to regulate the reserves of the chartered banks -- a monetary policy function. It may also use open market operations to aid debt management, acting as agent for the Finance Department.[F]

(59) It is difficult to serve two masters, and the Bank of Canada's securities department faces conflicts of interest between what is best for monetary policy, and what is best for debt management.[F]

(60) The Bank, as money managers might wish to tighten the banking system, while simultaneously the Bank as Finance's debt management agent wanted to finance at an advantageous rate. The bond market could be "rigged", by even easier money, until the new issue was floated off, after which the temporary money -- and even more to compensate for delay-- could be pulled out to tighten the system.

(61) Bruce King MacLaury, one time economist for the Federal Reserve Bank of New York, in a Ph.D. Thesis for Harvard, (on Canada's money market) February, 1961, pages 71-2-3, states with delicacy:

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Conflicts of Interest - continued

"Unlike the Federal Open Market Committee, which explicitly adopted a hands off policy with respect to easing the reception of new Treasury issues or refundings, the Bank of Canada has consistently geared its operations in the market on such occasions to meet the needs of the situation....This process of "sweetening the market" appears in retrospect to have interfered with the Bank's "dynamic" responsibilities on this occasion although at the time the authorities were just beginning to pull in the credit reins on the expansion of bank loans and were probably not aware of the conflict of interests. On other occasions the conflict has been quite apparent to the authorities and as a result the "sweetening" process has been all too transitory from the point of view of the dealers who have not been able to dispose of their own inventories of the new issue before the market fell....."

(62) Thus an outsider, sympathetic to Central Bank problems, remarks that the U.S. do not "rig" their markets for new issues, while Canada does, and he cites numerous examples. Ethics aside, the common knowledge of this "rigging and plug pulling", to use more earthy language, generates suspicion by both dealers and investors who were past victims of misleadingly attractive (for the fleeting moment) new issues. Solving the conflict of interest this way thus has its own costs -- loss of confidence, and diminished credibility for the Bank and its pre-issue "now-you-see-it-now-you-don't" easy periods. (F)

(63) Originally the Bank may not have sought too much responsibility for debt management, but this grew, perhaps inadvertently, when larger refundings plus the post-1957 deficits found the Finance Department lacking a well-staffed Debt Management Division, with its own economists, etc. Thus the Department may have leaned increasingly on the Bank for advice. This advice may have at times reflected more concern for monetary policy than for debt management, though the flavor may have been imperceptible to the Bank officials giving it. Eventually the camel may have enjoyed getting further into the tent.

(64) Sometimes the Bank may have been more conscious of its monetary aims when it gave government debt management advice, without full explanation. The 1958 Conversion was extolled as a "clean up" for

Conflicts of Interest - continued

"short term debt" (including some bonds not due until 1962-3-6), with the Minister even being induced to claim that the market viewed such bonds as due on their 1959-61-63 call dates, though they were selling well below par !!! Since the Minister was relatively new, maybe he was only repeating what he was told and believed he was selling a scheme of debt rearrangement, even saying of the Loan (which raised interest rates immediately) (Hansard, July 14, 1958 - page 2203):

> "....the beneficial results of this will extend well beyond the market for Canada bonds and into the market for provincial, municipal and corporate bonds."

(65) I regard this loan as primarily monetary policy, designed to strip the public of short Victory bonds, due 1959-60, because these, plus enlarged money supply, and more short issues for deficit finance, would create an overly liquid public, at a time when the economy turned to recovery, or even boom. That reduced liquidity, or a "tight money policy", was near, probably never struck the Ministers who, in apparent good faith were promoting a deal which "tight money" would turn into a trap.

(66) This is not a view from hindsight, for I would quote from a letter dated July 16, 1958, sent to the Governor by my partner and self.

> "We have been examining the considerations which we think would properly reflect the thinking of a Central Bank at this juncture. We think we would, as Central Bankers, come to the following conclusions:-
>
> 1. Large scale deficit financing for 1958-61 involves substantial monetary expansion.
> 2. Eventually this will create renewed inflationary pressures of major proportions.
> 3. The dampening of this inflation will require a cruelly tight money policy - (very low bond prices).
> 4. Such a policy cannot be too successful if there is excess public liquidity. (In other words, the public should not be allowed to own too many short term bonds which can be turned into cash by their early maturity, or by sale at a small loss).
> 5. It would seem necessary at this juncture to take steps to deprive the public of much of their liquidity. (In other words, the public must be induced to replace their short

Conflicts of Interest - continued

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Conflicts of Interest - continued

(66 contd) terms with long dated issues, which could, under tight money, be liquidated only at a substantial loss).

6. Since this situation exists in the United States also, there is all the more reason for meeting the problem here first.

Since however, we are not Central Bankers, but Bond Dealers, the same reasoning dictates that we, recognizing our primary responsibility to the clients we advise, examine how best these clients can be served. We also see:

1. Absolutely no evidence of any cutback in Federal spending.
2. Monetary expansion in the order of roughly $ 1 1/4 billion since August, 1957 (with the new $400 million issue).
3. Enough deficit financing in the next year or three to cause considerably more monetary expansion, or much higher interest rates in the long end of the market, or both, and when the inflationary pressures become severe, there may be a need for a severe money squeeze -- with very depressed bond prices.

These considerations should therefore cause us to counsel clients to preserve liquidity at all costs.

If we believe that the preservation of maximum liquidity would be in the best interests of the clients we advise, our participation in an enterprise involving switches to long bonds (which would reduce liquidity) cannot be wholehearted. In fact this participation might be mis-construed by those we normally advise, as a tacit endorsement of all such exchanges, and we would not wish this to happen.

We therefore think that the only honest thing we can do is to withdraw from the organization for the 1958 Conversion Loan forthwith, with the least embarrassment to all concerned......."

(67) In discussing this letter with the Governor, no attempt was made to disabuse us of our ideas which proved well founded within two months. We claim no monopoly for this view, in July, 1958, or now. We also viewed the marking up of Victory bonds prices, in one case by five points as unethical market rigging. (F)

Conflicts of Interest - continued

(68) An expert debt management division in Finance would have recognized the Loan for what it was; it might have been vetoed, or if authorized in modified form, Ministers would have been less enthusiastic in selling a monetary trap, or countenancing (if indeed they were aware of) the high pressure methods of the Bank and some dealers. I think the after effects, the huge dis-investment, reflected the fears of "tight money to come", plus real institutional resentment of the high pressure tactics. With more debt management responsibility in Finance, I think recognition of the conflict of interest would have ensued, and the country spared some of the disorderly markets of 1959.

(69) The Investment Committee of Unemployment Insurance Funds, which included Bank and Finance officials, acquired in July, 1958, long Conversion bonds, giving up its more liquid 1959-60 Victories, but a few months before predictable seasonal needs compelled liquidation of the long issues at substantial loss. An independent trustee, uninterested in debt management schemes, might have stressed liquidity. This conflict has now been solved by Ottawa giving UIF demand instruments, but there is no guarantee that Trust Funds may not again be used for debt management ends. Bank officials on these boards must compromise the conflicts of monetary policy, debt management and trusteeship (See Appendix III)

(70) Conflicts of interest are better settled at arms length between opponents of equal power and information, than by one agency serving two or three masters. I would hope the Bank will cease to be represented on Trust Fund boards.

(71) I feel that the Bank's activities in the bond market have contributed to its disorganization, because the bank chose to make monetary adjustments, which could have been effected in the bill or short area, in the longer area for purposes of debt management, to "produce a yield curve", or to "nudge" prices, all symptoms of conflict of interest, and bad compromise.

(72) Recently the Bank's incursions into the long area have been mainly as buyer, acting for the Purchase Fund. Yet as recently as January, 1962, the bank acquired a new issue of bonds due 1968, and attempted re-sale at a time when the banks were receiving a flow of post-Christmas cash from the public, something the Bank normally mops-up, lest it inflate bank reserves. It sold few bonds in what appears to have been a compromise between the

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THE FINANCE DEPARTMENT

THE MINISTER

(73) The Canadian Minister is overworked by comparison with the Secretary of the Treasury, a Presidential appointee, whose time in Congress is but a few committee hearings. The Minister must spend much time in the Commons. The Treasury Secretary does not prepare the budget (The Minister, in Canada, does), for the U.S. has a Budget Bureau, and there is another U.S. official, the Treasurer of the U.S. who may correspond to our Minister's other title of Receiver General. Maybe we should split the Finance Minister's job.

(74) I believe the U.S. Secretary can and does devote considerable time to debt management, on a scale physically impossible for a Canadian Finance Minister.

THE DEPUTY MINISTER

(75) Backstopping the Minister with material for use in the House, plus budget matters, are two jobs our Deputy has, which lack U.S. counterparts. There are two U.S. Undersecretaries anyway, one of whom is usually experienced in banking or finance. The current incumbent was, until a year ago, a senior official of the Federal Reserve Bank of New York, and devotes perhaps a majority of his time to debt problems.

DEBT MANAGEMENT DIVISION

(76) The U.S. Treasury Debt Management Division, adviser to the Secretary, contains perhaps twenty-five officials, including economists, researchers, and an actuary, who consult with bankers and government dealers, leaning little on the "Fed" until they conceive their own ideas. These may then be discussed with the "Fed" at a high level, so that compromises between debt and monetary policies can be thrashed out between equally powerful and well informed partisans.[F]

(77) We have many capable people in Canada's Finance Department, but carrying so many responsibilities, we do not seem to have a debt management division in depth, with research staff to match that of the Bank. Consequently much depends on advice screened through the Bank, and perhaps unconsciously flavored with monetary policy interests.

(78) Selling bonds is a unique function where Ottawa is <u>selling merchandise</u>, instead of taking taxes from pay cheques, or giving handouts to grateful citizens. Neither the overworked officials in Finance, nor the Central Bankers with experience in nudging a captive banking system have any background in merchandising, calculating public psychology, or demand,

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Debt Management Division - continued

and few have any background in the investment business.

(79) With a public relations campaign you can sell any merchandise -- good or bad -- perhaps once; but the bad eventually ruins the manufacturers reputation. The Conversion was a well publicized sale of unsuitable merchandise, witness the "refunds", and the bad taste yet extant. There is, I believe, more resentment about 4 1/2, 1983 selling at 93, because they were bought under pressure and exhortation, than about 3 1/4, 1979, at a 19 point loss, bought voluntarily.[F]

(80) If the Conversion damaged the reputation of Canada bonds to the point that subsequent issues have cost 0.25% extra yield, the cost per billion of subsequent financing is $2,500,000 per annum for the life of the bonds. New issues, including Savings bonds, but not bills, in 1959-60-61 total about $8.8 billions. I believe that the "tap loans" of the past year have also affected public confidence.

(81) I am not unmindful of the difficulties caused by the post-1957 series of deficits, but I reiterate that in these circumstances defects in debt management concept, technique, etc., are just that much more apparent and costly.

(82) I think we need a Debt Management Division in the Finance Department, with its own economists, research and perhaps marketing experts, capable of stressing debt management, not to be confused with the monetary objectives of the Bank. I realize that the best marketing experts probably earn as much or more than the Deputy, so we might need to create a Public Debt Commission, answerable to the Minister, but outside of the civil service pay scales (like the Bank or CNR presidency). The Chairman might be found in a Bank, and the marketing expert in one of the larger investment dealing firms.

(83) If the difference between the best and second-best debt management can shave interest costs by 0.125% per annum, (while perhaps aiding monetary policy too), we are discussing savings of $22 millions per year on the present debt alone, to be realized as it is refunded - or $1,250,000 per billion per annum on new issues.

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Debt Management Division - continued

This is a job for a marketing psychologist rather than an expert with a slide rule, or statistics which indicate that savings depositors should buy this, or banks "ought" to buy that.[F]

THE BUDGET

(85) While budgets may have once been a matter of adding up revenue and expense, stating the difference as surplus or deficit, we have now the concept that "X" or "Y" deficit or surplus was "appropriate" to the state of the economy on a contra-cyclical budget basis. The basic determinants were supposed to be the economic slack or otherwise, and the GNP expected.

(86) We know that such budgets can produce errors of the order of $200 millions through a small shift in GNP, so they are considered "hopes", and not rigid forecasts.

(87) Surely with this type of budget, it ought to be possible for the Speech from the Throne to give a "target" deficit or surplus, leaving the details for the regular budget.

(88) Are we not harming ourselves by carrying the British tradition of budget secrecy to ridiculous extremes in hiding what are really hopeful guesses -- the aggregate deficit -- until the full budget comes down? Even though the President does not know if Congress will pass the taxes involved, the U.S. manages to announce a budget target early every January. I advocate no premature revelation of tax or tariff changes, since our system of government gives 99% assurance that they will become law.

(89) Would we not be better with a rough gross deficit estimate, (speculating for a few months about taxes, etc.), than waiting for months to see when, or if, there will be a budget prior to election this year, or waiting until June in two recent years?

(90) It should not surprise you to hear that many would-be investors feel safer on the sidelines until the deficit is at least indicated. Since 1957 this uncertain mood is often reflected in pre-budget markets.[F]

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THE BOND MARKET

(91) The term "bond market" is a generality, for there are many markets, ranging from the government market to the market in speculative, defaulted corporate issues.

(92) There are two broad government market sectors. The short term market consists of Treasury Bills, and bonds up to three years in term. There is a good volume of trade, and new trading opportunities arise from price changes of as little as 0.01% to 0.05%. The long term market is narrow, with low volume, with even price changes of 0.25%, or 0.50% often generating little additional trade. It was not always thus in the long market, but the deterioration commenced some years back.

(93) In Canada and the U.S., most trade occurs in the short term area, the securities being interest-bearing cash substitutes, dealt in by banks and corporations with money to lend at short term. In this area Central Banks can vary commercial bank reserves by purchases or sales which have minimum impact on capital values, both mathematically and because of the broad market. (A 0.01% change in Treasury Bill yields means but $25 cash change in capital value per million, and a similar yield change on a 10 year 4% bond means a capital value change of $800). In the U.S., a New York Times article of January 21 suggests that 75% of the trade in U.S. Governments occurs in the under one year area.[F]

(94) The importance of the short market in Canada and the U.S. has grown in recent years, for the debt has become more concentrated in this area, and fluctuating prices have shown many long term buyers of the 1940-50 era that practical liquidity is not provided by the ability to sell a long term bond at a 10 point loss. Both nations have found it increasingly difficult to sell long issues, and in varying degree have reluctantly produced the desired short term issues.

(95) Participants in the Canadian short market include Bank of Canada, chartered banks, trust companies and other financial institutions, industrial concerns and junior governments, etc., plus two groups of dealers -- those who enjoy re-discount privileges at Bank of Canada (and hence cheap day-to-day loans from the chartered banks) and those who do not. The chartered bank loan facilities are augmented by what are called "country banks", industrial corporations, junior governments, etc., who will lend for a day, a week or a

The Bond Market - continued

month, at low rates of interest against suitable collateral. The securities eligible for re-discount at Bank of Canada (and hence for day-to-day loans from the banks) are Treasury Bills and Canadas under three years in term. In the aggregate the borrowings from the official money market are often less than those from "country banks" against similar collateral, while the "country bank" market is even larger when loans against other collateral, such as longer Canadas, provincials or finance paper are added.

(96) My firm was originally one member of the twelve dealers enjoying access to Bank of Canada funds. We withdrew from this group in about a year, for our line of credit was too small to finance an adequate inventory of more than one or two issues, for we do what is essentially a wholesale business. I understand that the lines of credit were given on the basis of total capital, and while our capital is and was small in relation to some of the larger firms doing a "financial department store" business, our capital is 100% available for the financing of government issues. Many larger firms have much capital tied up in sizable margin requirements for inventories or transit items in other types of securities. We feel that, without risk to our capital or customers, we have ample capital to carry six to ten times as large a position in short Canadas as the Bank allotted.

(97) We feel that the criterion should be that of our own bankers, i.e., the provision of adequate margin, currently not a prime factor in the Bank of Canada's repurchase activities.

(98) We have not regretted leaving the official money market, finding adequate accommodation from outside funds, (though at higher than day-to-day rates), for we can operate an adequate inventory, and are no longer subject to "suggestions" from Bank of Canada as to what issue or issues we should inventory. I suspect that profits have exceeded those we might have realized as continuing members of the money market, one reason being the freedom to expand or contract operations without hindrance or undue fear of official displeasure.

(99) I mention this because I think some official money market members have made excellent money in the short market, though the unofficial market may be more profitable to them than their relationship with the Bank. Others in the "club" may have done less well, and may at times indulge in activity because it is expected of them as continuing members of the official group. This may

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The Bond Market - continued

or may not benefit the market, over the long run, for such "shovelling smoke" may create difficulty for others.

(100) I would like to see the "money market" at the Bank thrown open to all government bond dealers, (with adequate margin the sole basis for lines of credit), as and when it suited such dealer to participate. I think that the net result would be the concentration of the continuing business in the hands of three or four dealers, most of the time, with the others constituting an expansion and contraction of the total market as conditions warrant, and as the spirit moves them voluntarily.

(101) The restricted "club" idea probably suits the Bank of Canada quite well, giving them an element of control over the members, keeping some of them in the market even when good judgment might suggest inactivity, and enabling the Bank to influence inventory details. Legally, as explained earlier, the official money market has no specified place in the Bank of Canada Act. This enabled the Bank to discriminate as between dealers, as regards lines of credit, using capital as a criterion, and to make such rules and regulations as it can enforce without driving dealers out of the market (even the allotments of new issues as between firms on new Canada issues can influence dealer thinking as regards Bank of Canada's wishes in the money market). The "club" idea gives the Bank some assurance of a number of "captive" bidders on bill issues, even if on only a token basis, something which might be lost if the market were open to all as they chose to come and go.

(102) Over all this short term government market has considerable breadth and depth, and with the growth of the "country banks", plus the proliferation of bank deposit certificates, finance paper and commercial paper, short term funds can work advantageously in a variety of instruments with little risk. I think the "official money market is, like the iceberg above the surface, probably a small part of the total, but being visible to all, is the indicator for other sectors.

(103) The long term market today seems incapable of absorbing any large volume of new Ottawa financing anywhere near the quotations, which in recent months have often been at such level as the Bank would pay for bonds as agent for the Government Purchase Fund. The long U.S. market suffers a similar disability, but is, I believe, at levels which reflect a lower content of official support. The Canadian market serves a useful purpose

The Bond Market - continued

at artificial levels serving as a yardstick for other borrowers, such as Ontario, Quebec, etc., whose long term securities are absorbed without too much trouble.[F]

(104) The January 21st article in the New York Times bore the heading "U.S. 'Bond Market' held a Misnomer", and blamed the thinness of the long market primarily on "Government intervention into the investment field.... tending to make long term Government Bonds more and more meaningless to investors....". The article cited the competition created for long Treasury issues by those of U.S. Government agencies, and particularly by Government guaranteed FHA mortgages. Canada's NHA mortgage, affording 6.50% to institutions, is far more attractive than long Canada bonds at just over 5%. The mortgage lacks liquidity, but so, in practice does the long government bond when a sale would produce a "book loss" which must be charged to current income.

(105) The Times also cites official interference in the long term market as further reason why it has deteriorated particularly since the Federal Reserve departed from its "Bills usually" policy in February, 1961, and tried to depress long term yields, by buying longer government issues.

> ".... a question hangs over the long term market...When can dealers and private investing institutions again appraise the desirability of buying or selling Treasury bonds on the basis of their own views as to the likely course of the economy and of interest rates? The government bond men insist that so long as this question is left unanswered by the public authorities the long term Government bond market is destined to become thinner and thinner. What private dealer or investor would take a chance on reading the minds of political officials or pitting private financial resources against the immense financial power of the Central Bank? .... Repeatedly, during the year, the dealers have sensed in the central bank's buying orders an effort to bring about a maximum of price change in certain areas of the market by the use of a minimum amount of Federal Reserve Credit. This would be a reversal of traditional open market operations of the bank -- to effectuate a maximum amount of change in the reserve positions of the nations' banks with a minimum of effect on the market standing of Treasury

The Bond Market - continued

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The Bond Market - continued

> Securities.......The growing indifference of the investment community to long term government bonds, coupled with the mystifying bent of the public authorities to tinker with market rates are causing bond men to ask what purpose is being served by offering long term bonds for public subscription....." (New York Times, January 21, 1962)[F].

(106) For nearly a decade after abandoning the "pegged" bond markets which made the "Fed" an involuntary engine of inflation, the Board dealt mainly in Treasury Bills, or other very short instruments, in adjusting commercial bank reserves. Its very rare departures from this policy were usually to correct disorderly markets. This policy is well described in two pamphlets attached. One is by Winfield Riefler, the former executive assistant to the Board Chairman, reprinted from the Federal Reserve Bulletin of November, 1958. The other is by Mr. Riefler's successor, Ralph Young, and Charles A. Yager, reprinted from the Harvard Quarterly Journal of Economics for August, 1960.

The policy of "bills usually" rests on two basis:

(107)

1. Open market operations should be carried out in the broadest sector of the market, where they will have the least effect on capital values. Arbitrage will diffuse the effect throughout the longer market. The purpose of the operations is to regulate the cash reserves of the banking system -- not to mastermind all interest rates.

2. When operations are carried out in longer, thinner areas, such as long term bonds, they will repel some customers from the market, while attracting a speculative following. In the end the authorities may end with a level of rates largely of their own making, rates which have no particular relationship to where the government could borrow, and rates which may change when the support of the "Fed" and its speculative following is withdrawn. Such operations may permanently damage the long market by permanently repelling some erstwhile participants.

Early in 1961, at the behest of the President, the "Fed" began (108) to purchase government issues in the medium, and later the long term area, to keep long yields down, while letting Treasury Bill yields rise to retain foreign short term balances in the U.S. The operation was considered a moderate success in some quarters, a failure in others, while yet others claim that as it succeeded in keeping long yields lower than they would otherwise have been, the policy attracted foreign borrowers to New York in increased volume, thereby increasing the outflow of long term capital. Long U.S. rates are among the cheapest in the world. Like the long Canada market, the U.S. Treasury levels perform a yardstick function for other borrowers.

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The Bond Market - continued

(109) Chairman Martin of the "Fed", testifying before a Joint Economic Committee of Congress, January 30, 1962, discussed the "Fed's" purchases since February, 1961, compared to the total volume of trade:

> "In the five to ten year area, the proportion amounted to more than 20% for the year as a whole and in the period March through July was more than a third of the total. For securities maturing after ten years, official purchases comprised over 30% of all market purchases for the year, and nearly two thirds of total purchases in the second quarter, when the bulk of official purchases were made....."

(110) Questions by committeemen, implying that the "Fed" should have made larger purchases, lowered long term rates further, produced the exchange, reported by the Goldsmith Nagan Service of Washington; reproduced in part as an appendix to this submission. (See Appendix I and Appendix II)

(111) Mr. Martin's reply implied that he was afraid of destroying the long term market completely, by expanding the "Fed" operations beyond the share of the market mentioned above. He feared the permanent loss of some investors who had been "captive accounts", by custom, or by laws, which are now often being changed. (See Footnote to 105)

(112) I digressed into this U.S. situation for a very good reason. Bank of Canada has always dealt beyond the short term market, sometimes when implementing monetary policy, for reasons connected with debt management, for government accounts or Trust Funds, in re-selling its draw-downs of new issues, and for motives which can only be guessed at other times, such as straightening the yield curve. I believe the Bank, by becoming such a large force in the market, has disrupted it and shrunk it, in the process acquiring a huge portfolio of long term issues which still overhang the market.[F] It has "rigged" the market when it pleased, the most glaring example being the five point mark-up on the 1966 Victory issue during the Conversion. It virtually closed the market for two months, by capturing the dealer organization during the same Conversion. It exercised pressure on ultimate buyers during that Loan, and its control of dealer's allotments on new issues may discourage concerted criticism. It has had so many forces at its disposal that prudent souls

The Bond Market - continued

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The Bond Market - continued

may well feel the longer Canada market is an artificiality to be avoided. (See also Footnote to 105). By comparison, the provincial markets seem relatively free from official domination, except as they reflect the Canada market. By comparison, the twelve month digression of the "Fed" into the medium-long bond market, an operation giving Chairman Martin grave doubts, is a relatively minor act compared with the Bank of Canada's interference over many years.

(113) During the War, national imperatives, public innocence of inflationary dangers, scarcities of goods and alternative investment, made the "rigged" government bond market "the only game in town". Now with alternative outlets for funds which are not too risky, plus the history of official interference in the marketplace,some investors may be avoiding the Canada market, with two exceptions, firstly, as short governments provide a satisfactory substitute for cash in the bank, and secondly as the medium or long market occasionally appears to be an attractive vehicle for essentially speculative funds.

(114) Complete rehabilitation of the long market may await the millenium, when inflationary psychoses, which cause lenders to demand penalty interest rates, may vanish; when government ceases to create new money in sufficient quantity to validate general rises in prices and wages, or to finance deficits on the grand scale now appropriate to election campaigns; when external pressures such as balance of payments deficits reveal that the printing press does not guarantee full employment, and that politicians in small countries are not sovereign for long when they violate sound economics. The balance of payments solution may come about when we face the world wide competition of cheap goods, made in nations with sound money.

(115) We could in the meantime attempt some rehabilitation of the market by making an honest woman out of it, by the scrupulous avoidance of official interference, actual or potential, even if this means cancelling the Bank of Canada's long portfolio,* reinstitution of limits on the Bank's long holdings, placing government trust funds at arms length with Bank and government, and letting the securities investment fund

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* Until 1954 the Bank could hold over 10 year bonds to a limit of five times its capital and rest - i.e., $150 million on today's basis. It actually holds $1,186 millions.

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The Bond Market - continued

operate openly through the Finance Department. Must we keep such a Fund, which can be a tool for official manipulation and interference with a free market, whatever its original purpose?

(116) We could cease having the Bank of Canada subscribe for all or part of new issues, only to dump them into the after market. It is already legally or ethically wrong for corporate borrowers to use affiliates in this fashion. While the King may be above the law, when he chooses a code of ethics denied to others by law or custom, he must expect to be considered a slippery fellow.

(117) We could restrict the Bank of Canada's open market operations, necessary to adjust chartered Bank reserves, to the bill or short term bond market, with arbitrage alone diffusing the effect through the longer market. Some deplore a government bond market without any official "friend" exposing it to a host of private speculative pressures. I happen to think that the private pressures would cancel themselves out by inciting trade at different times, at different levels, and at different volumes, according to the judgment of a few hundred or thousand individuals. I believe that the official "friend" has been abusing the market for its own ends for years.[F]

(118) It is not practical in Canada to have new issues underwritten by the few banks, but the U.S. practice often involves banks buying bonds, paying for them by crediting the Treasury with new deposits. These the Treasury withdraws over a week or three. In the meantime the individual bank may immediately sell the new bond at a loss, deriving greater benefit from the use of the new deposit, or it may sell it later, or keep it, as its position dictates. Since there are some 13,000 banks, these decisions made by individual "underwriters" -- thousands of them -- made a market in a way that the monolithic decision on a re-offering by one large underwriter -- the Bank of Canada for example -- never can, for the selling decision is in one set of hands.

(119) A "free bond market", with the government on one side, and the underwriters and lenders on the other, would be an arms' length situation, with the judgment of the marketplace setting the level. This is something of which officialdom seems afraid, and the penchant for meddling or "rigging" is an open admission of fear, fear of the judgment of a market,

The Bond Market - continued

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The Bond Market - continued

which must thus be captured somehow or other to do the government's bidding. All the excuses offered for fiddling, rigging, brainwashing, exhortation, etc., add up to a disbelief in the principles of a free market, among which is that borrowers want to get money cheaply, while lenders want the most they can get.[F]

(120) I believe that the borrower, the Government of Canada, is having difficulty in borrowing at long term in part because of its deficits, and in further degree because it has not left the market free from official interference. It is paying for its past sins. Canada presently is not growing noticeably faster than the United States, yet the spread in government bond yields is now far wider than the half of one percent of fifteen years ago in the long end, in the face of much more official interference here.

(121) Current trends carried forward for a few years of recurrent deficits suggest that governments may have to resort to regimentation (perhaps disguised as social security), or may be borrowing most of their money at short term, (a kiting of cheques as it were). At this point the nations creditors can force monetary expansion on governments by refusing to renew maturing issues, forcing government to resort to the banks, i.e., overt money creation.

(122) Thus I believe we must attempt to restore the Canada bond market to a position of freedom from official interference. After a period of recovery from a twenty year period of captivity, it may again become an area in which government can finance its needs, freely, and without suspicion.[F] (Excerpts from Radcliffe indicating some difficulties. See also Appendix IV.)

SAVINGS BONDS

(123) Between August 27, 1957 and February 7, 1962, the gross debt of Canada increased 26.5%, while the proportion represented by Savings bonds grew 82%. Savings bonds grew from 15.2% of the debt to 21.8% of the debt in this period. This $4 billions in demand money constitutes a redemption threat.

(124) I believe this to be a good thing, rather than a bad thing, just like the growing body of short term government marketable debt. Like the demand deposits in a bank, the presence of creditors who can demand

which must thus be captured somehow or other to do the government's bidding. All the excuses offered for fiddling, rigging, brainwashing, exhortation, etc., add up to a disbelief in the principles of a free market, among which is that borrowers want to get money cheaply, while lenders want the most they can get.(1)

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[illegible]

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The Bond Market - continued

their money at will, or in a short while, tends to impose a discipline on government.

(125) It might not be beneficial to have a large Conversion Loan in which short term claims against the government were consolidated, pushed off into the future, if the government again commenced a new build-up of short term debt.

(126) There is no valid reason why a prime credit, a government or a commercial bank, should fear redemption of large demand liabilities, unless it contemplates actions likely to bring its reputation into disrepute. Central Banks' objections would stress, of course, the contribution made to public liquidity.

CONFLICTS OF INTEREST

(127) The bond market too has conflicts of interest, which may work against the investor. When I entered the business we spoke of "clients", implying that a dealer, like a lawyer, primarily served his "client" ahead of other interests. This may have been a depression view, a reaction from the late 1920s, when dealers' heavy underwritings caused them to turn clients into customers, on whom the dealer unloaded merchandise just as a store or Fuller Brush man would. By the 1930s many of these securities were sour and many an innocent "client" who patronized an "honest broker" ended up as the "customer" of the broker's underwriting affiliate with a portfolio of the firm's issues, which the brokerage department would seldom advise him to sell. This condition still exists, with little recognition of the conflict of interest. The customer is no more sophisticated, perhaps, but economic conditions, and a little more care in selecting underwritings, have not produced the losses of the early thirties. It is probably a wrong concept, long ago banished in England, where brokers, jobbers and underwriters are different firms, seldom connected, each recognizable for what it is.

(128) With corporate issues the investment dealer may tend to stress the interests of the borrower (who could easily seek another underwriter) above those of the customer, or investor, (once called client) for there are more customers than issuing corporations!

(129) (There are exceptions, such as the borrowings of Ontario and the Ontario Hydro, where the issues long ago grew so large as to encourage the growth of one syndicate which contained almost all the large investment houses. These two borrowers must deal with the group since there are no

alternative groups obviously large enough to underwrite the issue. Smaller Provinces can resort to competitive tenders. Ontario seems happy with the present system, and its issues sell well.)

(130) In the Government of Canada market there is a similar conflict of interest to that in the corporate underwriting field. Bonds are offered by the Bank, less a commission (from 0.15% to 0.75%), to each dealer in a certain amount based upon his past activities in new Canada issues. It is true that sophisticated large investors will seldom pay the full price for these bonds, generally insisting on a trade whereby they obtain "over the market" for some other issue, thus obtaining often most of the dealer's "Commission".

(131) For those who deal in wholesale lots, the remaining .05% to .125% is quite profitable, though the whole commission concept is a bit of an illusion.

(132) The dealer however is very conscious that he gets an allotment of X% of a new issue from the Bank, and would risk having this reduced in subsequent loans should the Bank dislike his record of "distribution", whether in total or to some class of buyer (such as a bank, if Bank of Canada currently frowned on such sales). This places the dealers as captive sub-underwriters of the Bank, enjoying certain privileges "during good behaviour", enabling the Bank to wield considerable influence - in the minds of many dealers. It also tends to give the public the impression that the dealer is fundamentally the hired agent of the Bank or Government, rather than a free agent or honest adviser.

(133) The pressure exerted by some dealers during the Conversion Loan, the lack of complaint in public re-market rigging, and particularly the Investment Dealers' Advertisement urging Conversion, re-inforced this impression generally, while giving others the view that the dealers had allowed the generous commission to dull their critical faculties.

(134) I think this impression may be overly harsh, and would hope that dealers will learn to avoid such close and uncritical relationship with a borrower--particularly a Federal Government. Yet I can see a need for eliminating any chance of undue influence by Government or Bank on dealers, just as other examples of dealers favoring borrowers over investors should be deplored.

(135) I feel I can mention this because my firm doesn't deal with "the small investor", confining our efforts to dealing in Canada bonds with financial institutions, sophisticated large corporations, and of course our

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I feel I can mention this because my firm doesn't deal with "the small investor", confining our efforts to dealing in Canada bonds with financial institutions, sophisticated large corporations, and of course our

competitors in the industry, who are capable of making their own decisions.

(136) The solution I would suggest is that all Canada bond issues be offered at a net price, without commission, to all comers, with an honest, flat-percentage allotment on all orders above \$25,000-\$50,000 (which would "protect" the small investor -- for a guaranteed full allotment up to the \$25,000-\$50,000). The dealer who thought a new issue overpriced could refrain from subscribing without prejudicing his chance at the next issue which might be properly priced, or underpriced. The institution would have the same choice.[F] This is roughly the U.S. method, and its only disadvantage is that a failure or near failure is very soon obvious, whereas our method buries failures between the almost mandatory subscriptions of dealers (to protect their position on future allotments) and the bonds swallowed by the Bank of Canada. Canadian issues are always "fully subscribed" or "over subscribed". The market may know broadly what has happened, but the public and Parliament seldom do.[F] The U.S. system often reveals that X% of the public holders of a maturing issue spurned the refunding and took cash.

(137) One of the results of depressed bond prices over the past decade has been that the volume of trading by insurance companies has declined in part for book-keeping reasons. For instance a trade from Canada 3 1/4s due 1976 to Canada 3 1/4s due 1979 may have appeal at a cash "takeout" of 2 1/2 points. But, if the book value of the 1976s happens to be 100, a sale at market, a price of 83, immediately involves a "realized book loss" of 17 points which must be charged to this year's operations under current rules. This is enough to effectively rule out many trades of this nature. The inability to trade, when investment considerations make it attractive, primarily because of book-keeping drawbacks, tends to make the market thinner than it would otherwise be.

(138) Mathematically it also means that insurance companies are most likely to extend term when yields are low and bond prices high (since there are few or no book losses), while inhibiting such trades when prices are low, and yields high. If Canada 3 1/4s due 1976 were worth 100, as in the past, it is altogether likely that a trade into 3 1/4s due 1979 would involve a "pay-up" of half a point to a point, rather than the "take-out" mentioned above.

(139) Those who are slaves to yield books may be able to prove that the exchange where they pay out additional money is as good (or better) a deal than the same exchange where money is taken out, but common sense indicates otherwise.

(140) Surely there is an argument for amending the insurance act to permit the trading of one Canada issue for another, with any "book loss" being written into the new bonds. In the instance mentioned above (the trade of 3 1/4s due 1976 for 1979 on 2 1/2 points "take out") the result would be a new "book value" for 1979s at 97 1/2, as against the old book value of 100 on 1976s.

(141) This matter has been taken up with Ottawa before and has received a favorable hearing in some quarters. It may have been turned down finally by the Finance and Insurance Departments because some people wished to extend the principle to Provincials and Municipals, which I agree would be hazardous, since there have been occasions in the past when trades between one Province and another, or between one municipal and another constituted a definite downgrading of security.

(142) These objections should not apply to exchanges of one Canada or Canada guarantee for another bond of the same debtor. I believe that anything of this nature, which enables trade to take place without artificial barriers, would make for a broader and healthier market.[F]

EXCHANGE, BALANCES OF PAYMENTS ETC.

(143) I have deliberately refrained from detailed comment on balance of payments problems, exchange reserves, etc., though they affect the Bank of Canada, the Finance Department and the bond market. They merit extended treatment in themselves.

(144) Yet Canada may some day need to orient its monetary policy in directions dictated by these external forces, which can prove stronger than the wishes and legislative enactments of the Parliaments of small nations.[F]

(145) We may some day have a fixed exchange rate, by agreement with IMF, or we may have a de facto stability in exchange rate because the authorities wish to "peg" it approximately at some level. In these circumstances inadequate exchange reserves may bring a monetary policy which is designed to import short term funds from abroad by way of appropriate interest rates.[F]

(146) If this is ruled out by domestic considerations, then a fixed dollar and low exchange reserves, plus a large balance of payments deficit, may suggest a return of import controls or some form of exchange and capital movement controls.[F] This would of course aid in financing the

Federal Government by restricting the avenues for spending in a very liquid economy, but it brings with it the inflationary consequences of restricting the pressures of excess liquidity to the domestic economy.

(147) Exchange controls would bring the government -- whatever party is in power -- into dual disrepute. Economically the stupidity or inept execution of economic policy, past or present, would be evident to many here and abroad. Legally the Government would be engaging in peacetime regimentation (to avoid the full price of its mistakes), which might invite evasion, avoidance and contravention, bringing with it a further public disrespect for law and democratic government.

A. H. CAMERON

TORONTo, ONTARIO
MARCH 1, 1962.

APPENDIX I

Digest of Testimony on THE PRESIDENT'S BUDGET & HIS ECONOMIC REPORT, before the Joint Economic Committee, January, 1962
By Federal Reserve Board Chairman, Wm. McC. Martin
as reported by the Goldsmith-Nagan Service

Senator Proxmire: "You seem to imply that you couldn't have played a much more aggressive role with regard to obligations of five to ten years and ten years and over because you were already such a big factor in the market. That is, when you account for 20% of the trading, you might feel that if you did any more you would destroy freedom in the market. Would that be correct?"

Mr. Martin: "That is correct. It is always a matter of judgment. I think we went as far as we could in this -- as far as we were warranted."

Senator Proxmire: "There are just two things that bother me about this. In the first place, when you are this big a factor it seems to me that you can play a really important part so far as the economy is concerned in lowering interest rates on long term obligations, to the great benefit of the economy. In the second place, I notice, for example, between June and September, the Treasury Department purchased $1 billion of additional long term securities, apparently, or at least they advised government agencies and trust funds to do so, while the Federal Reserve increased their portfolio relatively slightly, $63 million, which is small for that."

Mr. Martin: "Well those trust accounts were being invested for longer term reasons. The last thing that the Federal Reserve ought to do in my judgment is to destroy the long term market. We want to sell long term Treasury bonds, and we want a good long term market. There is the very nature of the long term market. A lot of people seem to think that these long term securities are just here on a shelf the way they are in a grocery store, and that you can just go up and grab some of them. Here is a pension fund in a trust account that hasn't any intention of selling a long term Government security. You don't have too many of those people left in this country. You start playing around with that market and after a while, the first thing you know, you have no market. We got up to 33% of dealing in that market, we haven't been faced with the problem of selling. I think we have gone as far, and this was a matter of judgment that weighted heavily with the Federal Reserve open market committee in its discussions every three weeks, we have gone very far in attempting to disperse throughout the market, without trying to control or make the market or return to fixed interest rates."

Senator Proxmire: "But the difficulty is that your additional purchases have been concentrated very largely in the one to five year category. As far as the impact on housing loans -- the area where monetary policy is it seems to me most constructive, useful and encouraging -- these are much longer term and we still have these relatively high interest rates compared to most of the past periods."

Mr. Martin: "I have tried to emphasize repeatedly here that it is the flow of funds that we are concerned with, and I think the record of the second quarter indicates that we were quite successful on the flow of funds because we had a record number of state, municipal and other securities floated in that period with a maximum of stability in interest rates. In other words, we did have some (increase in rates). I never claim too much because arbitrage does occur in the markets, and we are not in a position to fix rates unless we become the market entirely and put ourselves in the position where the way the government sells its securities is to sell them to itself, which I think is a very unfortunate thing... We were successful in having a strong flow of funds in the second and their quarter of this year, in the longer term market. I believe our activities and the Treasury activities made some contribution to that."

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Mr. Martin: "Well those trust accounts were being invested for longer term reasons. The last thing that the Federal Reserve ought to do in my judgment is to destroy the long term market. We want to sell long term Treasury bonds, and we want a good long term market. There is the very nature of the long term market. A lot of people seem to think that these long term securities are just here on a shelf the way they are in a grocery store, and that you can just go up and grab some of them. Here is a pension fund in a trust account that hasn't any intention of selling a long term Government security. You don't have too many of those people left in this country. You start playing around with that market and after a while, the first thing you know, you have no market. We got up to 33% of deals in that market, we haven't been faced with the problem of selling. I think we have gone as far, and this was a matter of judgment that weighted heavily with the Federal Reserve open market committee in its discussions every three weeks, we have gone very far in attempting to disperse throughout the market, without trying to control or make the market or return to fixed interest rates."

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APPENDIX II

"The Federal Reserve System", (Harper, New York, 1960) contains a chapter on open market operations by C. Richard Youngdahl, one of the leading New York government security dealers. In part:-

"The practice of dealing only in short term securities was adopted formally in .... 1953, following a broad enquiry by an Ad Hoc Subcommittee of the Federal Open Market Committee.....headed by the Chairman of the Board of Governors....shortly after the Federal Reserve discontinued its practice of interfering directly in both the long and short term sectors of the market....... This intervention, the subcommittee found, had left its mark on the government securities market....there remained an uncertainty about system intentions that was detrimental to the...."depth, breadth and resiliency of the market". The subcommittee recommended..that the System confine its operations to very short term securities, preferably bills, where the direct impact....on the market would be at a minimum. It also recommended... instructions...to make it clear that the System did not intend to interfere lightly in the long term market under the guise of "maintaining orderly markets"....such action is to be taken only to correct a "disorderly situation"....after other measures have failed.

Prior....it had been the practice of the Federal Reserve to intervene...to support "rights" values on maturing securities during a.....refunding. The subcommittee found this practice detrimental of the efficient operation of the.....market and to run counter to.....formulation and execution of credit and monetary policy. It recommended that the practice of direct intervention to support...refinancing operations be discontinued, leaving the Treasury to insure....success...by the proper pricing of its new offerings.....

Since that time the System has only once....intervene(d) in the long term market because of disorderly market conditions.....The capital market no longer expects, wants or needs such intervention ....

It is of course always tempting to advocate direct Government interference with market processes in order to substitute official judgment for that of the market place....The basic questions raised in opposition....are rather whether the monetary authorities would be prepared to accept the disruption in the private capital markets that such action might engender, whether these markets then could satisfactorily function.....and whether the Treasury under such circumstances could finance in any size outside the short term area........"

APPENDIX III

"HOUSE OF COMMONS, CANADA, MINUTES OF EVIDENCE # 10.
STANDING COMMITTEE ON INDUSTRIAL RELATIONS, June 9, 1959"

(Part of exchange between Hon. Paul Martin and Mr. James E. Coyne, Governor of the Bank of Canada and member of the Investment Committee of the Unemployment Insurance Fund. (Page 365-6))

Mr. Coyne: "The unemployment insurance fund held about $300 millions of Victory bonds....all of which bore 3% coupons...They converted them in accordance with the options made available by the government....It was in the interests of the fund to convert from a 3% to a 4 1/4% bond....over the long view the major benefit to the unemployment insurance fund....was getting a higher interest rate.

There are, I think, two further points...in relation to your question: instead of converting, it should have sold its Victory bonds, or perhaps, after converting, it should have sold its conversion bonds earlier on. The fund could not possibly have sold their entire holdings. It was much too large for the market to take. It would have ruined the market, and been disadvantageous to the fund to try to sell......"

Mr. Martin: "Was there not a period from July to the end of October when the bank maintained the market and the price of the converted bonds and victory bonds?"

Mr. Coyne: "Yes the bank made a two way market and it was active....However the bank was not there holding a basket for anyone to take advantage of. We were, we hoped, running a two way operation and assisting investors who were out of balance and wanted to sell some part of their holdings.......

There was no way the unemployment insurance fund could have sold a large quantity of bonds at that time. If the banks or insurance companies, or anyone else, has said they were going to dump huge quantities on the market, it would have been a smash, and they did not do so. I do not think the unemployment insurance fund could have either."

Mr. Martin: "....It would have been possible to sell the victory bonds of the commission rather than have them converted, would it not?"

Mr. Coyne: "No, it would not."

Mr. Martin: "Why would it not?"

Mr. Coyne: "In my judgment you could not have found sufficient buyers for $300 millions worth of Victory bonds."

Mr. Martin: "Well, assuming that was not the case, there was no obstacle, apart from that, to prevent you from selling the victory bonds, rather than converting them."

Mr. Coyne: "There was no obstacle, other than our best investment judgment..."

(This bears on conflicts of interest between the Bank of Canada's responsibilities, and on the question of who were the sellers of Victory bonds and/or Conversion bonds in large blocks during and just after the Conversion Loan. Were there any sellers whose collective holdings approached in size the $300 millions owned by Unemployment Insurance? If so, did the public interest demand that they be given a privilege of which UIF considered itself incapable of exercising? AHC)

APPENDIX IV

(EXCERPT FROM ARTICLE BY A.H. CAMERON, OCTOBER, 1957)
ENTITLED: HIGH LONG TERM INTEREST RATES!)

CAN CENTRAL BANKS FORCE LOW INTEREST RATES ON A MARKET? DOCTOR DALTON.

England provides two examples of unsuccessful attempts to place bond issues at rates of interest which were contrary to general public expectations.

After successfully maintaining roughly a 3% interest rate during the war, Chancellor Dalton decided he should drive long term interest rates down to 2½% or less. Accordingly he took every opportunity to revise the public expectations by propounding his view that interest rates were too high and he was going to be successful in lowering them. He then lowered the Treasury bill support rate by 1/2%, and in short order "Consols" rose in price, declining to a 2-3/4% yield.

As Prof. F. W. Paish says, on this matter "So long as interest rates are falling and prices...are rising, the movement will be assisted by those who hope for capital profits from its continuation", especially those whose high tax brackets made sixpence of capital gain worth £1 of interest. In other words the speculators got aboard Dr. Dalton's band wagon. Many INVESTORS doubted if less than 3% was a fair rate of interest.

It proved difficult to drive rates from 2-3/4% to 2½% as skeptical investors sold, preferring cash. Dalton had Government accounts (controlling over 3 billion pounds) buy in the bonds, and push up the market, unloading Treasury bills as they did so. Banks bought the Treasury bills, creating new deposits which, via the government accounts, went into the hands of the sold-out investors. The Bank of England created the necessary reserves to support the expansion in bank deposits. The Bank of England had just been nationalized.

There were so many skeptical bondholders who preferred cash, that the resultant stuffing of bills into banks, and deposit expansion, was dangerously inflationary. The Government got "cold feet". The market wobbled, the speculators took their profits and the government accounts were left holding the long term issues. In principle the attempt was similar to the Federal Reserve's "pegging", but at increasing prices.

The aftermath was a shrunken long term bond market in Britain, and recognition that a market "made" by government accounts was not only "rigged", but could only stay "rigged" at the cost of what was really the printing of vast quantities of money. The "rentier" examined the plans for his euthanasia, didn't like them, and abandoned "gilt-edged" in marked degree. (This almost unbelievable story is abridged from "Modern Banking" by R.S. Sayer of the London School of Economics, 1953 Edition).

Sayers, in a footnote, claims Parliament knew Trust Funds were being used to manipulate the market, but took no action.

Though Dr. Dalton's ill fated 2½s sold as low as 36½ in 1961, there is little hint of this episode in "Radcliffe". The impression that British markets are resigned to official domination, and that few have the "free market" concept still extant in the U.S., may be an unfair judgment. Yet if it has any validity, could this be one of the reasons for the malaise in British gilt-edged over the decade and a half following Dalton? See also Sir Roy Harrod's comment Footnote #119.

Though Canadians, officials of institutions, seldom complain publicly about official coercion, many may have quietly engaged in overt market activities which evidence such displeasure. It might be difficult to duplicate the Conversion Loan of 1958. AHC

F O O T N O T E S

In the interests of brevity, footnote sources are abbreviated.

RADCLIFFE REPORT	means	Report of the Committee on the Working of the Monetary System. (HMSO, August, 1959, Cmnd 827)
RADCLIFFE EVIDENCE	"	Principal Memoranda of Evidence Committee on the Working of the Monetary System. (HMSO 1960, Volume number as mentioned.)
U. S. DEALER MARKET	"	A Study of the Dealer Market for Federal Government Securities, Material Prepared for the Joint Economic Committee of the U.S. Congress. (U.S. Government Printing Office, 1960)
BANK OF CANADA REPORT	"	Report of the Governor of the Bank of Canada for the year mentioned.
FEDERAL DEBT	"	The Federal Debt, Structure and Impact, by Charles Cortez Abbott. (20th Century Fund, N.Y., 1953)
McLAURY	"	The Canadian Money Market, Its Development and Its Impact. Bruce K. McLaury PhD. (Thesis for Harvard, February, 1961)
AHC	"	Comments by the Writer.

FOOTNOTES TO:

Paragraph #4

Though Keynesian ideas of contra-cyclical deficits may account for the degree of monetary expansion in 1957-62, Ludwig Von Mises suggests another cause in the 1953 edition of "The Theory of Money and Credit", pages 426-8, which is tenable to students of political psychology.

Von Mises argues that politicians, though rejecting the ideas of inflationist quacks, though aware that inflation is self defeating, can nevertheless justify actions which cause inflation by claiming that the nation faces other evils much more dangerous.

Von Mises suggests a situation where government, supported by a minority, sees an emergency justifying large increases in public spending and corresponding austerity in private spending. But the majority of the people either disagree as to the seriousness of the situation, or are unwilling to pay increased taxes. Von Mises suggests that government then rejects the democractic way of persuading the majority, and assumes the right and power to circumvent the majority by deceiving the public as to the costs involved. Though complying with legal processes, government then changes its role from that of elected officeholders to guardians of the people -- Fuhrers, if you like. To quote:-

"....the majority...(is) not prepared to defray the costs incurred by their rulers' policies. They support these policies only to the extent that they believe their conduct does not burden themselves. They vote...only for such taxes as are to be paid by other people...because they think that these taxes do not impair their own material well being. The reaction of the government... is, at least sometimes directed by the sincere wish to serve what it considers to be the true interests of the people....But if the government resorts for this purpose to inflation, it is employing methods...contrary to the principles of representative government ....taking advantage of the masses' ignorance....cheating the voters instead of trying to convince them.

"It is not just an accident that...inflation has become the accepted method of monetary management. Inflation is the fiscal complement of statism and arbitrary government...a cog in the complex of policies and institutions which gradually leads toward totalitarianism...."

A cynic might suspect that the "emergency" justifying some deficit spending was merely the imminence of an election..AHC.

Paragraph #5

"RADCLIFFE EVIDENCE" (Vol. 2, Para 42 of submission by Issuing Houses Association:- "If monetary controls have not been as effective as they were before the War, the cause may lie in:-

1. The high level of taxation...has reduced the effectiveness of of small changes in the rate of interest. Providing profits are being made, the effective cost....is....the net rate after tax.

3. The redistribution of income from the saving classes to the spending classes has...increased the velocity of circulation and added an unknown amount to the effective money supply..."

Paragraph #6

"GRAHAM TOWERS", Toronto, January 25, 1962, at Canada Life meeting:- "But international conditions have been changing rapidly since 1956, and we have to compete with a number of major countries which, so far at least, appear to have had relative success in keeping their costs of production in line. When this situation gives rise to unused capacity and unemployment in the higher cost countries, attempts to stimulate the economy by public spending and monetary expansion can hardly be regarded as effective long term solutions....."

FOOTNOTES TO:

Paragraph #6 (continued)

"GRAHAM TOWERS", Speech at Toronto, November 9, 1950:- "....If one sets aside the war debts of certain countries, it is true to say that Canada has a larger foreign debt than any country in the world....a large part of which is composed of marketable securities, (which) does mean that we are exposed to swings in foreign opinion. If non-residents, particularly residents of the United States, take a dark view of the Canadian picture, they can give effect to that view by selling some of their tremendous holdings of Canadian market issues, and withdrawing their capital from Canada...."

The portfolio investments of foreigners in Canada were $4.7 billions at the end of 1950, and $9.5 billions at the end of 1960. Source, Bank of Canada..AHC.

Paragraph #9

"FEDERAL DEBT", Page 206-7, "....as the government needed more funds, the country experienced a species of double talk. The Treasury repeatedly professed that it did not want the banks to buy bonds, for this would inflate the money supply. It wanted its securities bought only by savers, since these would reduce their own personal expenditures as the government increased its own. It is true that even when savers bought bonds, they received relatively liquid assets, which they might later decide to redeem or sell........

Unfortunately for this theory, the desire of the government for easy financing required that the banks possess excess reserves.... But banks with excess reserves naturally seek the liquidity and income that come from investing them in government securities... The net result was that the money supply increased from $65 billion in 1939 to $165 billion in 1946...a new and sophisticated king of greenbackism...."

This wartime parallel is of interest because of Canada's deficit financing of 1958-62, largely resulting in dollar-for-dollar increase in the money supply. At times the authorities discourage the buying of certain issues by banks, and at other times tried to sell bonds to the public against existing savings..AHC.

Paragraph #23

"LORD NORMAN", Sir Henry Clay, 1957:- "Though quite as independent by disposition as Cunliffe, Norman had learned from experience the necessity of carrying with him, through their representatives on the Committee, both the Court and the City community outside.... For urgent business, if important enough, a special meeting would be convened, or, if that was not practicable, a meeting of such members as could be got together. In the Committee again, he found his chief advisers and helpers, though these were always in addition to one or two of the Clearing Bank chairmen or general managers and partners in the larger private banking houses on whose advice he relied. While he was still Deputy-Governor he arranged for a weekly meeting with the Chairman of the Discount Market Committee and in practice he saw successive chairmen of the Stock Exchange Committee almost as regularly....."

Paragraph #27

"GRAHAM TOWERS". Speech at Toronto, Jan. 6, 1936: "There is a school of thought...which regards a Central Bank as an institution unlikely to do much good, but I do agree that a Central Bank in undesirable hands would be dynamite indeed. It could so easily become of real significance in ways which would constitute the greatest injustice. It is desirable that there should be a sounder knowledge of Central Bank operations...the main factors. Enlightened public opinion is the greatest safeguard a Central Bank can have....."

Paragraph #29

"MODERN BANKING" (R.S. Sayers, Oxford 1953) page 59. "The authority of the State over the Central Bank is always necessarily absolute. All that is open to question is the extent to which the sovereign body should detail its commands to the Central Bank--for the monetary laws are such commands."

FOOTNOTES TO:

Paragraph #29 "THE FEDERAL RESERVE SYSTEM"(Harper, N.Y. 1960) page 19, states: "The intent of the Congress....was that the Federal Reserve.... should be independent....not independent of Government, but independent within the general structure of Government. This does not mean that the system can or should pursue a course....contrary to....national economic policies, but....within the framework of those general objectives, it is to have freedom to exercise its....judgment independently."

"THE RESERVE BANKS AND THE MONEY MARKET" (Randolph Burgess, Harper, N.Y. 1946 edition, Preface) "The principal change has been wartime subordination of Central Banks to Treasuries in all countries. The principal question is how much independence they will regain."

Since the Kennedy regime's installation there has been discussion of an amendment to the Federal Reserve Act, making the term of the Chairman co-incide with that of the President. A.H.C.

Paragraph #30 "RADCLIFFE EVIDENCE". (Vol. 2, para. 50 of submission by the Accepting Houses Committee) - "....if an official request remains in force for too long it may have an effect entirely different from that which the authorities intended. An example (is) the requests....made to the banking community to restrict advances.... to hire purchase finance companies....(which) have now had the effect of stimulating such companies to invite direct deposits by....the public."

Paragraph #33 "RADCLIFFE REPORT", para. 942.....".... We recommend.....that the banks should....offer term loan facilities within reasonable limits....as an alternative to a running overdraft for credit-worthy industrial and commercial customers...."

Paragraph 58. "BANK OF CANADA REPORT, 1956", Page 23:- "The job of a Central bank is to manage the money supply in such manner as to contribute both to economic growth and to stability of prices. It can make its contribution, and use its influence, but it cannot ensure the total achievement of either objective."

Paragraph #59 "BECKONING FRONTIERS", (Marriner Eccles, Knoph, N.Y., 1951) Page 494, contains the following anent Treasury attempts to continue "Pegged" bond prices:- "....a final move in a Treasury attempt to impose its will on the Federal Reserve. If swift action was not taken....the Federal Reserve would no longer have a voice in deciding monetary and credit policies. It would lose the independent status Congress meant it to have, and, in its most important function of open market operations, it would be reduced to the level of a Treasury bureau."

The "Fed" regained its freedom in 1953...AHC.

Paragraph 62. "McLAURY", Page 38:- "In summary then, the Bank of Canada entered the 1950s with a long history of successful open market operations in government securities. This "success", however, was based solely on experience during periods when it had not been necessary to use such operations to implement a restrictive monetary policy. The bond market was well developed, partly as a result of the Bank's own efforts, but the Bank's dominant position in this market restricted its freedom of action."

Paragraph #67. "BANK OF CANADA REPORT, 1958", Page 3-4:- "....the Canada Conversion Loan of 1958 made possible a return thereafter to non-bank financing of Government bond issues and a halting after early October of the monetary expansion which had been necessary to that time.." Page 5:- "The reform of the structure of the Government debt, and the contribution it made to improving conditions for the sale of future issues....to non-bank investors, were important elements in monetary policy in the broadest sense and an essential anti-inflationary achievement."

FOOTNOTES TO:

Paragraph #67 (continued)

This suggests that the Bank, by early 1959 was beginning to admit the monetary policy (as distinguished from debt management) attributes of the Conversion Loan, which had facilitated a "tight money" policy, culminating in the famous August, 1959, Treasury Bill Auction. By October, 1959, Canada was selling 5 1/2% Convertible bonds at a discount..AHC.

Paragraph #76

"RADCLIFFE REPORT", para. 535. "....debt management can be regarded neither as something to be...left to the last and adjusted to all other policy decisions, nor....as a consideration which should override all other policy decisions...."

"RADCLIFFE REPORT". para. 51. "To a far greater extent than between the wars monetary problems and problems of debt management have become inseparable."

"THE FEDERAL DEBT" page 5, "Debt management....the prerogative of the Treasury, impinges on credit regulation and control....the responsibility of the Federal Reserve. Thus the possibility of dispute between two key Federal agencies arises...the degree of independence....for the central bank is....one of the issues at stake. Again, the way in which a large debt is managed affects both the supply of....and the value of money....Since under the Constitution, the regulation of the value of money is one of the powers given the Congress, new problems....emerge."

Paragraph #79

"FEDERAL DEBT", Page 188 - "Opinions...will differ as to which... issues involved in....debt management is of the most consequence. In the author's mind the basic question is the future of the quasi-regulated market that in the United States has commonly been described as the free market process....Is a politically controlled money market compatible with the free market process?.... Or...., what kinds of monetary controls are practical if an economy is not to lose its free market character?....How much discretion in administering a price should a governmental administrator have? How far, and for how long, can he force a price against the will of the market without creating....the semblance of a black market?....at what social costs in other areas are his results achieved? To what extent should he be permitted to employ compulsion, a non-economic measure, to achieve economic goals....? And if he is permitted to use compulsion, will the ultimate results be better and socially more acceptable than....if determination of the market's course had from the outset been left in the hands of the people? Certainly compulsion....will seriously disturb the investment habits of persons and institutions, upon which many debt management procedures in the past have been based."

This is relevant to the Conversion Loan, the present situation, and the 1961 "Operation Nudge" of the Federal Reserve System.
A.H.C.

Paragraph #84

"RADCLIFFE REPORT" para. 533. "throughout the postwar period, the dominant motive of the authorities...has been the desire to "fund", i.e. to lengthen the average life of the securities outstanding. The policy....has its roots in earlier ideas about debt management...designed to protect the Treasury from maturing claims.... In recent years...the obvious relevance of the structure of the debt to the abnormal liquidity of the economy has led to more explicit emphasis on funding as "an aid to monetary control"....The authorities have had to take a view....of the psychological reactions of the market to attempts to explore, by deliberate manipulation of terms, the possibilities of market demand; unwillingness to take the risk of market resistance has ruled out anything that might be labelled "juggling"....

"FEDERAL DEBT", Parge 167:- "....this is an argument that, in the long run, even the Treasury can disregard only at its peril the needs of the market and the wishes of its customers. For if these needs are not met in some fashion moderately satisfactory

FOOTNOTES TO:

Paragraph #84 (continued)

to those who buy and keep government securities, the natural wish of debt owners to liquidate their holdings will create very serious problems.

There is another reason also for respecting...the wishes and requirements of the market. Funds for debt ownership can be allocated in only two ways, voluntarily and compulsorily. If sufficient funds are not allocated voluntarily, fiscal authority must resort to compulsion. That is its last recourse. And if its policies have departed too far and too long from the wishes of the market and the needs of the actual or potential buyers, it is in the position of having itself created the conditions that require compulsion. Unwillingness....to make its obligations competitively attractive...notwithstanding....the number and character of these alternatives, leads ultimately to the use of force--the final mandate of the state...."

Published in 1953, these observations were pertinent to the Conversion Loan, and the situation today. The underlining is mine. A.H.C.

Paragraph #90

"RADCLIFFE EVIDENCE" (Vol. 2, para. 42, of brief by Issuing Houses):- "Also, at or near budget time the market is usually not receptive to new issues...."

Paragraph #93

"U.S. DEALER MARKET" figures for 1948-58 show that issues under one-year in term constituted from 71% to 84.6% of total trading, while those of over five-years in term ranged from 4.9% to 15.9%. To show the trend in long term trading, these averaged 15.6% in the first two years, 1948-9, and but 7.5% for the two latest years 1957-58. (Page 65)

Paragraph #103

"RADCLIFFE EVIDENCE" (Vol. 2, brief by Committee of Scottish Bank General Managers, para. 36 iii):- "Confidence in the gilt-edged market has declined to the point at which the banks are obliged to rely mainly on maturities rather than on sales of investments for the replenishment of their liquid assets."

Paragraph #104

"BANK OF CANADA REPORT, 1956", Page 32:- "Loans by governments to favored borrowers financed from other sources would insulate such favored borrowers from competition in the loan market, but would render more intense the competition among the rest for the remaining (smaller) supply of loanable funds, and interest rates--including interest rates on government securities--would rise still more."

"Page 36" - "In discussions with the chartered banks we have also spoken of the desirability of....making insured mortgage loans under the National Housing Act".

Since 1956, housing interest rates advanced above the legal 6% ceiling applicable on Bank Loans, and Ottawa has become a large direct lender on mortgage loans, thereby adding to the government's borrowings. The availability of 6 3/4% and 6 1/2% NHA Loans, Government guaranteed, provides some competition with long term Government bonds for institutional and other funds. A.H.C.

Paragraph #105

"RADCLIFFE EVIDENCE" (Vol. 2, brief by Council of Stock Exchange, paras. as follows:-

15. Official operations by the authorities...take two main forms:-
a. Selling stock off the Departments' portfolios....recently issued and still held by them.
b. Purchase of the next maturity against sales of other stocks....
16. These operations and the manner in which they are conducted have become the predominant technical factor affecting the behavior of the gilt-edged market...it would be a rare issue which was not available from official sources the

Paragraph #94 (continued)

to those who buy and keep government securities, the natural wish of debt owners to liquidate their holdings will create very serious problems.

There is another reason also for respecting...the wishes and requirements of the market. Funds for debt ownership can be allocated in only two ways, voluntarily and compulsorily. If sufficient funds are not allocated voluntarily, fiscal authority must resort to compulsion. That is its last recourse. And if its policies have departed too far and too long from the wishes of the market and the needs of the actual or potential buyer it is in the position of having itself created the conditions that require compulsion. Unwillingness...to make its obligations competitively attractive...notwithstanding...the number and character of these alternatives, leads ultimately to the use of force--the final mandate of the state...."

Published in 1953, these observations were pertinent to the Conversion Loan, and the situation today. The underlining is [illegible]

Paragraph #90

"RADCLIFFE EVIDENCE" (Vol. 2, para. 12, of brief by Issuing Houses):- "Also, at or near budget time the market is usually not receptive to new issues...."

Paragraph #93

"U.S. DEALER MARKET" figures for 1948-58 show that issues under one-year in term constituted from 73% to 84.5% of total trading, while those of over five-years in term ranged from 4.9% to 15.9%. To show the trend in long term trading, these averaged 15.0% in the first two years, 1948-9, and but 7.5% for the two latest years 1957-58. (Page 65)

Paragraph #103

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FOOTNOTES TO:

Paragraph #105 (continued)

moment dealings began.....

18. On a falling market official sales can, unless very delicately handled, produce a very unstable market and destroy the normal conditions created by supply and demand with the resulting loss of investors' confidence in gilt-edged stocks....

19. These open market operations....create a pattern of market conditions...closely scrutinized by.....investors. Their interpretation of this pattern, which is created by the government's monetary policy has become....important....in deciding....investment policy.

26. It is asked how new types of investors can be attracted. The need is rather to create conditions which will bring back the old....."

Paragraph #112

"FEDERAL DEBT", Page 151:- "If the....Reserve System.....continues to be..."stabilizer", both for the economy as a whole....and for the government securities market:...then the Reserve Banks' portfolios will....be more or less shaped by the action of other classes of debt holders. This is, the Reserve System, as the residual purchaser, will (have)....the size and makeup of its holdings directly affected by the purchases and sales of other classes of owners....its purchases and sales will in turn be influenced by the general fiscal and financial policies of the government...."

The dis-investment by the general public, and any special deals done with banks, determined the Bank of Canada portfolio trend, willy-nilly, once they "pegged" the market in mid-1958. AHC

Paragraph #117

"McLAURY", Page 294:- "....the pivotal role of the central bank in all phases of the government securities market probably diminished the predictive usefulness of changes in the prices of these securities; on occasion the bank may well have experienced difficulty in distinguishing between the effects of its own operations (and induced reactions to these operations) and the effects of non-official forces of supply and demand in the market. In fact, one of the strongest arguments advanced by proponents of a "bills only" policy is that open market operations conducted in short term securities minimize the chances of a central bank leading itself astray."

Page 305:- "....we might explore briefly the feasibility and desirability of operations in "bills only". With respect to feasibility there does not seem to be any particular reason why the Bank could not limit its operations to purchases and sales entirely in bills (if we exclude debt management responsibilities). Suppose for example that the Bank wanted to offset a rise of 10% in reserves caused by, say, an inflow of foreign capital. In dollar terms this would work out to between $80 and $100 million. With the exception of the depletion of its bill holdings which occurred in connection with the Conversion Loan, the bank has maintained a portfolio since 1955 ranging roughly between $300 and $500 million. Nor is there reason to think that the market could not absorb sales of this magnitude....In the more likely cases in which the demand for bank credit were expanding, there is still reason to believe that the non-bank public could absorb an increase of this size without undue congestion in the market. During 1959 for example, the non-bank public added nearly $350 millions to its holdings of Treasury bills...It would appear... that from a strictly technical point of view, the Bank of Canada could probably maintain control of the money supply without recourse to operations in securities other than bills...."

FOOTNOTES TO:

Paragraph #119 "SIR ROY HARROD", 'Policy Against Inflation' (MacMillan, 1958), displays some fears of what would happen to the gilt-edged market if the "Departments" were ever operated solely in the interests of the beneficiaries. I can see a parallel in the administration of Unemployment Insurance and other Canada government Trusts...AHC.

Pages 237-8:- "I may note....that I see a danger....which might, however, take us by surprise and overwhelm us. This is from the purists. Some voices have already been raised that the Departments should invest their funds in the way most advantageous, from the point of view of yield and liquidity, to the interests for which the funds are held. From the point of view of the purists, this claim is unanswerable; that is why it is so dangerous. We have to run our economy subject to all sorts of limitations and handicaps...our position is already prejudiced... by past history. One of our greatest assets is....the Departments' funds, which give us a degree of freedom in the wise management of the monetary system that any other country might envy. Do not let us lose this freedom for the sake of a merely abstract piece of logic. Let us hold it and keep it and cherish it."

Should Trustees who thus plead, be continued in control of Trust Funds?...AHC.

Paragraph #122 "RADCLIFFE REPORT", Para 68:- "....Since the War the Treasury has had....a.....succession of debt maturities and the necessity of financing....the nationalized industries and local authorities....in a gilt edged market that for many years was gradually realizing that inflation was eroding all fixed money values. The chronically weak market has...been resistant to substantial sales....at any prices...."

Para 490:- "....The authorities can raise interest rates without difficulty since the Bank of England...can name its own price for every maturity in which it chooses to trade. It can safely sell more....government paper, at the longer end of the market...until people become persuaded that the rate of interest is going to be higher than it used to be. But when it wants to reverse the operation it has to be prepared to pour out cash in exchange for bonds...and this glut of liquidity is likely to be a great embarrassment in the future when a change in the economic climate makes restraint and high rates appropriate once more. This consequence would be more pronounced the more artificial the operation appeared to be. There is no doubt that....deliberate manipulation of long interest rates...would be distrusted as artificial juggling with markets...."

Para 544:- "....Since the War the nature of demand for debt has changed, while the authorities have not been prepared...to press for the minimum cost of debt service, but have attached high importance to increasing the average life of the outstanding securities...."

Para 562:- "....The debt manager's task looks straightforward enough, once he is over that awkward preliminary, the diagnosis of economic trends. He has only to lower interest rates.....or to raise them and make it less liquid by selling more long bonds...."

"RADCLIFFE REPORT" Para. 563. "....Witnesses from the Bank of England and the Treasury strongly contested this view of the demand for securities....because....the market in long term securities is dominated by expectations of future prices and is therefore seriously liable to react perversely to a movement of prices....."

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Should Trustees who thus plead, be continued in control of Trust Funds? AHC

"RADCLIFFE REPORT", Para 58:- "....Since the War the Treasury has had.....a.....succession of debt maturities and the necessity of financing...the nationalized industries and local authorities....in a gilt edged market that for many years was gradually realizing that inflation was eroding all fixed money values. The chronically weak market has...been resistant to substantial sales....at any prices...."

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FOOTNOTES TO:

Paragraph #122 (continued)

Para. 565. "....A more substantial fear is that a drop in bond prices, especially if it appears to be the result of deliberate action, may be repeated; to the extent that this happens, a rise in interest rates will....reduce the demand for bonds.....as the Governor of the Bank said...."there is always a price at which buyers will appear. That is doubtless true, but the price might be a long way down, much damage might be done on the way...."The evidence we have heard from financial institutions supports the Governor's judgment....he was judging markets as they have functioned in this decade....conditioned by the circumstances of the times and one of these circumstances has been a lack of contact between the minds of the authorities and the minds of outside operators and commentators."

PARAGRAPH #136

"RADCLIFFE EVIDENCE" (vol. 2, paras. 17 & 18 of submission by British Insurance Association:- "....Because of their large resources they are desirable underwriters and their ability to retain heavy allotments.....where an issue is poorly subscribed imparts a measure of stability to the new capital market...As regards underwriting it appears that insurance companies usually underwrite about 50% of a new public issue...."

Though these figures refer to non-U.K. government issues, the amounts involved exceed £110 millions per annum. Could insurance companies help underwrite Canada issues, if they were available at a net price, thus producing a diversity of underwriting as against the system of Bank of Canada holding large blocks of new issues temporarily? A.H.C.

Paragraph #136

"RADCLIFFE REPORT", para. 580 .....".....we find the customary announcements of full subscription unacceptable. No one supposes that they mean anything more than that the....Bank has taken up the unissued balance....On balance, we recommend that the maximum amount of issue be announced in the prospectus... and that the closing of the lists should be followed by an accurate statement of sales outside "the Departments".

Paragraph #142

"RADCLIFFE EVIDENCE" (Vol. 2, para. 39, of submission by British Insurance Association) contains reference to the British practice of writing down both security portfolios and required policy reserves when there is a substantial rise in interest rates. This has the effect of eliminating the "book value" or "original or amortized cost" concepts which eliminate many trading opportunities in Canada. A.H.C.

Paragraph #144

"LORD NORMAN", Sir Henry Clay, 1957, Page 436 (With reference to the 1931-39 exchange policy in England):- "They (The Chancellor and the Governor) learned empirically the lesson that a country with a weak and uncertain external position cannot commit itself to a fixed rate of exchange, because a fluctuating rate is the only safeguard (except Exchange Control) against undue depletion of its currency reserves: and the corollary that with a floating rate, control of domestic credit conditions must be even stricter than it is when the danger signal of a weak exchange automatically compels credit restriction."

Paragraph #145

"LORD NORMAN", Sir Henry Clay, 1957, Pages 459-60:- "The Governor did not regard the suspension of the Gold Standard as a reason for relaxing the control....over domestic credit... he was alarmed by the increased scope given to political exigencies by the increased influence in the money market of the treasury. He felt the loss of the compulsion exercised by an adverse movement of the exchanges on the Gold Standard.... A floating exchange rate, if a convenience, was also an added danger: when there was any pressure on the country's external payments, a fall in the rate might increase the alarms which caused the flight from Sterling which the lowering of the rate was designed to check...."

FOOTNOTES TO:

Paragraph #145 (Continued)

"GOLD AND THE DOLLAR CRISIS", Robert Triffin, Yale, 1960. Page 45. "most of the major countries would aim at maintaining a reserve level of not less than 40% in most years, feel impelled to adopt severe readjustment measures if this level fell below, let us say, 30% or 33% (of gross imports), and consider themselves forced to adopt drastic measures of control in the face of any persistent or substantial contraction below that critical range".....

Doctor Triffin's figures show Canada's percentage of reserves to gross imports as 55% in 1950, 43% in 1954, and 29% in 1957. Though our merchandise imports may be a little larger than in 1957, our non-merchandise out-payments, on a net basis, may be several hundred millions larger for 1961, while our exchange reserves are no larger, and our total foreign debts a good deal more. If you accept the jargon that a permanent foreign investment here is an "international debt", the increase since 1957 may be in the order of $7 billions.

Mr. A. T. Lambert, now President of the Toronto Dominion Bank, suggested back on June 17, 1960, that we should have increased these reserves some years back "in order to give us greater independence in our internal policies". A.H.C.

"GRAHAM TOWERS", Toronto, January 25, 1962, at Canada Life meeting:- "Any other country which attempted to run an international current account deficit of the size we have experienced in recent years relative to our national income, would long ago have had to devalue its currency, impose stringent import restrictions, curtail its domestic activities, or a combination of all three policies. The current examples around the world are too numerous to mention. Only Canada has been readily able to borrow from other countries on a scale required to offset the large deficits."...."What is to be desired is a distinct tapering off in our reliance on others before we come to the point where our credit standing is impaired."

The Honourable Dana Porter,
Chairman, and Members
The Royal Commission on Banking & Finance,
Ottawa.

Gentlemen:

A Brief by Frank O'Hearn
(14 p - 7 sets)

I respectfully beg to make the following Submission for your consideration:

According to our National Charter, the issue of money in Canada and the control of credit rests exclusively with Parliament.

In actual practice however, Parliament has through the various Acts dealing with banking, money and credit, turned its Right to issue money and control credit over to the Bank of Canada and the Chartered Banks.

Parliament did this moreover, without demanding or getting credit from the banks for the new money issued on its behalf. Unfortunately, the methods employed by the banks didn't provide for payment to Parliament of the monetary credits to which it is entitled.

Accordingly, the people of Canada have inadvertently been cheated out of billions of dollars, and it's now clearly up to Parliament to get the credits from the banks to which it is still entitled, so as to recoup our losses and comply with the terms of our National Charter.

The need for this extra money is indicated by widespread involuntary unemployment, huge unpaid public and private debt, inflated living costs and inflated production costs, and by the continuing shortage of our available capital supply etc.

I submit that a huge shortage in our available money supply is clearly indicated by examination of the government's financial statements, and the combined statements of the banks, and these I am prepared to submit in detail for your consideration if you so desire. For the purposes of this Submission, I submit that the need for a vast improvement in our taxing, banking and monetary procedures is clearly indicated by the following facts, viz.;

According to government figures, our gross national revenue is presently running at a rate of about $36 billions per year. For a population of 18 millions, this is equivalent to $2,000. per capita per annum.

Our money supply however, as indicated by the amount of our bank deposits and pocket money, is equivalent to only $1,000. per capita, a total of only $18 billions.

From these facts, it's obvious that half of our year's revenue has vanished. In other words, our national money supply is short a total of $18 billions, equivalent to $1,000. for each man, woman and child in the country.

It is the loss of this revenue money that has caused our present financial and economic problems, and I submit that the recovery of this money is the first and foremost task confronting your Commission and the government and people of Canada.

So as to recover this huge amount of money, I've developed THE FRANK O'HEARN FORMULA to improve current, taxing, banking and monetary procedures, in which I offer to the government and people of Canada the choice of several practical and feasible methods, as follows;

1 - A new method to encash taxpayers cheques;
2 - A new method to encash bond collections;
3 - A new tax plan;
4 - A costless checking method.
5 - A costless method to repay bank loans.

I beg to submit details of these alternative methods in EXHIBIT NO. 1 attached.

The many benefits which would accrue to the government and people through the use of this Formula are too obvious to need recounting here in detail. The replacement of the revenue deposits cancelled by the government and banks, and the use of these increased banking resources as a permanent monetary fund, would place the government and people in a sound and solvent condition. The proper recording and balancing of our public and private accounts would remove the fear of further depressions or inflations, and would avert further undue fluctuations in the domestic value of our money. It would end involuntary unemployment and discriminations, and would provide markets freed of restrictions and undue competition. The tax reductions it would make possible would reduce our production and living costs and prices to our common benefit.

The attached Exhibit No. 1 deals with our domestic economy only and doesn't touch on the problems of international trade and settlements. In this area of International Exchange, I beg to submit O'HEARN'S COPYRIGHTED FORMULA FOR INTERNATIONAL MONEY, which I've developed to provide a sound international dollar for world trade and settlements in place of existing methods and media. The details of this proposed international money Formula are contained in the attached EXHIBIT NO. 2, which I submit for your consideration.

This Submission sets forth the fundaments of the Formulae I've developed to improve our current taxing, banking and monetary procedures and to provide ourselves with an international dollar for our foreign trade and settlements. My Formulae is intended to bring about an era of peace, prosperity and security and so escape further disasters from our financial follies. Everybody will benefit, and nobody will lose if this Formulae is endorsed by the Commission and implemented by the government in the public interest.

This Brief is submitted by

FRANK O'HEARN

October 24th, 1961

Director
The Office of Valuation and Exchange
(A private Research Institute)

59 Bethune Blvd.,
Scarboro, Ont.

P.S. - If this Commission decides to recommend the use of this Formulae by the government in whole or in part, or if the government decides to use it for the benefit of itself and the people of Canada, such use should of course, be on an attributable basis, because of its great potential value and because of the great cost to me of its development. Frank O'Hearn

P.P.S. - I seek a personal hearing before the Commission to support my Brief if its validity is questioned. Frank O'Hearn

EXHIBIT NO. 1

COPYRIGHTED FORMULA
by
Frank O'Hearn

The purpose of this Release is to re-state and clarify the Formula I've developed over the years to improve the prevailing taxing, banking and monetary procedure, in the following manner, viz.;

A NEW METHOD TO ENCASH TAXPAYERS CHEQUES:

If this method were to be used by the government of the day in order to get its money's worth, all it would have to do would be to issue instructions to the tax Collector that he must until further notice charge the government's bankers for the full amounts they get from the taxpayers banks to cover the tax cheques. To do this, he would have to charge them with double the face value of the tax deposits. This means in other words, that all tax collections would henceforth be collected from the taxpayers banks in addition to the amounts collected from the government's bankers for deposit of the tax revenues. This is necessary so as to make up the shortage caused by the government's mis-use of public funds to cover its own cheque payments twice over.

This extra tax collection from the banks is essential so as to ensure that the taxpayers cheques are properly paid and encashed. It is also essential to do this so as to avert the cancellation of the taxpayers money and to avoid a shortage in the government's own bank accounts, which follows the use of the present methods.

The collection of these extra amounts would double the receipts from the taxation, and it should be carried out until the accumulated deficit shown in the government's financial reports is completely wiped out. To put it another way, the collection of the extra amounts should be carried out until the deposit assets of the banks are at least equivalent to the amount of investment and loan assets they now hold.

Fortunately, the payment of these extra amounts to the government won't cost the banks anything inasmuch as they already have collected in more than enough to permit them to cover their customers tax payments in full, instead of covering them for only half their cost value, as they now do, and cancelling the unpaid balance.

The collection of this extra money is necessary as I find that when the government deposited its revenue collections, it failed to get its money's worth from its bankers in return. As a matter of fact, it got only fifty cent's worth from them in return for each dollar it deposited.

This is because the money the government deposited actually cost twice as much to get out of the banks in the first instance, as its face value indicated. This is so because twice the amount of cash assets that was actually needed, was foolishly used to cover payment of the revenue cheques and other funds deposited by the government. The face value of the cheques deposited was covered from out of the taxpayers cash account, and from the cash holdings of their bankers too.

Because the government didn't get its money for its face value, it should have charged its bankers with double the face value of its revenue deposits so as to get its money's worth from them in return.

Because of its faulty method of handling its money and of recording its accounts and transactions, the government has already cheated itself and its taxpayers out of $18 billions.

In view of the foregoing, the first duty of the government is to collect in the balance from its bankers needed to adjust the revenue deposits it has already made. It obviously should do this before it collects in any further taxes of any kind.

One way to do this is for the government to henceforth encash the tax cheques from the taxpayers banks as well as from its own bankers, or else demand credit from its own bankers for the full amounts tendered to them by the taxpayers banks to cover the tax cheques deposited.

A NEW METHOD TO ENCASH BOND COLLECTIONS:

The foregoing Formula for getting in the full value of the taxpayers cheques could be also used by the government to get in the full value of its bond cheques deposited with the banks. The payments for the government bonds should be encashed directly or indirectly by the purchasers banks as well as by the government's bankers. This would double the government's receipts from the sale of its bonds.

A NEW TAX PLAN:

If this alternative method were to be used by the government of the day to collect in additional capital, all it would have to do would be to levy a special tax on the banks to get in the tax money and bond money coming to it from them to adjust its revenue deposits.

This tax-the-banks proposal is intended to show how simply the government could get in the tax money which it let the banks hold back from it when it deposited its tax collections with them. Collection of the extra money should proceed forthwith inasmuch as the cheque payments have already been charged by the banks against the taxpayers accounts.

This proposed tax would not be a tax on the bank depositors or shareholders. It would be a tax on the banks themselves, and they would have to pay the tax by way of deposits to be set up by them in favor of the government.

The extra credit balances would of course, increase the banking liabilities, but these extra liabilities would be offset by permanent debit balances listed on the asset side of the banking statements as deposit assets. In this way, the true financial condition of the banks would be shown for the first time.

If deemed advisable, the banks could issue drafts or cashiers cheques in favor of the government and this paper, when endorsed and deposited by the government, could be held as collateral by the banks to the proposed debit balances.

In view of the huge amount of tax money the government is entitled to get from the banks, the tax levies to make up the shortage could be made on the instalment plan as the money is required by the government.

In this method like the others proposed, the extra amounts could be paid by the banks without cost to themselves or to the shareholders or depositors. This is because the cost has already been paid in full, and the recovery of the money would be freed of further cost.

This tax-the-banks method could also be used by the government to get back from the banks the amounts they over-charged it in connection with its borrowings and cheque payments, as well as to get back the amounts the banks short-changed it in connection with its revenue deposits.

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A COSTLESS CHECKING METHOD:

If this alternative method were to be used by the government of the day to pay its accounts, all it would need do would be to issue its cheques in the usual manner together with instructions to its own bankers that they must honour and take in the government cheques without charging the amounts in the usual manner against the government's bank accounts.

Insofar as the banks are concerned, all they would have to do in this regard when they take in the government's cheques, would be to certify them and hold them as permanent negotiable banking assets against their deposit liabilities, and hold them as assets in place of the money they pay out to take the cheques in from the Payees banks.

In other words, the government could by this costless checking method pay its creditors by way of cheques without any cost to itself whatsoever. The government could legitimately do this until it finally recovered all the money due it by the banks.

A COSTLESS METHOD TO REPAY BANK LOANS:

If this alternative method were to be used by the government of the day in lieu of the foregoing methods, it could repay its bank borrowings without any cost to itself or the public whatsoever. It could do this until the current cash deficit in the national economy is replaced with bankable funds.

The use of this new method would also be a new departure in current banking procedures and could be resorted to if deemed preferable to the other methods outlined in my Formula. In order to demonstrate just how readily this method could be utilized by the government, I actually applied it in connection with my own personal accounts with my bank in the following manner;

Back in 1958 I arranged for my bank to purchase securities to a total of $11,000. and I deposited a further $11,000. worth of securities with it as collateral. My bank proposed that it make me a loan for $11,000. and credit the proceeds to my savings account. Though the purchase of the securities and the loan to me were two different and separate transactions, when I got the bank's statement thereof, I found that it had debited me with a total of $22,000. and credited me with a total of $11,000. only. On taking the matter up with them, they stated that this was their usual method of handling and reporting all such transactions. I however, protested that they mishandled and mis-reported my transactions and that they had either over-charged me or short-changed me in a total of $11,000. The bank refused to correct the accounts or remedy my protest.

I subsequently had them sell a portion of the securities for $3,000. which they credited to my savings account and out of which I instructed them to transfer $2,000. to the credit of my loan account, reducing the latter to $9,000. In reporting my transactions up to that point, the bank had debited me with $24,000. and credited me with only $15,000., making the $9,000. which prevailed until I recently took the matter into my own hands for settlement.

A COSTLESS CHECKING METHOD:

If this alternative method were to be used by the government of the day to pay its accounts, all it would need do would be to issue its cheques in the usual manner together with instructions to its own bankers that they must honour and take in the government cheques without charging the amounts in the usual manner against the government's bank accounts.

Insofar as the banks are concerned, all they would have to do in this regard when they take in the government's cheques, would be to certify them and hold them as permanent negotiable banking assets against their deposit liabilities, and hold them as assets in place of the money they pay out to take the cheques in from the Private banks.

In other words, the government could by this costless checking method pay its creditors by way of cheques without any cost to itself whatsoever. The government could legitimately do this until it finally recovered all the money due it by the banks.

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I subsequently had them sell a portion of the securities for $4,000. which they credited to my savings account and out of which I instructed them to transfer $4,000. to the credit of my loan account, reducing the latter to $7,000. In reporting my transactions up to that point the bank had debited me with $22,000. and credited me with only $15,000. making the $7,000. which prevailed until I recently took the matter into my own hands for settlement.

I therefor recently divested my bank of the loan collateral it held for me by having deposits of outside money made in exchange for the collateral and having the proceeds credited to my savings account. This provided me with a deposit balance equivalent to the loan debt it had charged against me.

Inasmuch as my bank turned over my collateral to my broker against payment and credited the proceeds to my savings account, I then recognized the debt and notified them of my desire to pay it off in full. I pointed out however, that because of the manner they mis-handled my previous repayment, I couldn't pay off the balance in a similar manner.

This is because my bank cancelled my $2,000. of savings money when they got it from me in repayment, in place of turning my money over to Parliament where it undoubtedly belongs. Hence, they improperly cut this amount from our available national money supply. I pointed out also that my Formula is intended to permit the repayment of bank loans without the cancellation of the customers hard-earned money in the usual banking manner.

I stressed my desire to keep my savings money in circulation and insisted that after we squared up our contra indebtedness, my money must be with either one of us. Hence, in order to safeguard my savings money and to give effect to my Formula, I then cancelled my indebtedness to my bank and retained the money and applied it as a partial capital return to offset the huge costs of developing my Formula over the past 30 years.

I also stress the fact that if I were to pay my bank its loan charge in the customary manner, I would be mis-handling my money and mis-reporting my transactions, and I would also be cutting $9,000. from my savings balance and my bank would be cutting $9,000. from off its loan assets, making the repayment cost $18,000. to discharge the $9,000. loan debt. This inflation of repayment costs would cause a $9,000. loss in our money supply and would be altogether too costly. I could have no part in such an improper and illegal procedure.

My action of course, constituted a new departure in the handling of our money and the recording of our banking transactions, and creates a precedent which could be properly followed and adopted by the government of the day, or by other banking customers should the government fail to take advantage of my Formula.

It's clear that by my action, I have averted a loss of $9,000. in our money supply. I divested my bank of the loan collateral and stripped it of its evil power to forcibly close out my accounts and cancel my savings money in the usual banking manner without turning the capital profit over to Parliament.

So as to give my bank further opportunity to remedy my complaints on its own, I advised it that I would be quite willing to pay it the loan debt providing it would undertake to keep my savings money in circulation and report it as an asset, for obviously the banks should report deposit assets as well as deposit liabilities. I also required it to report a $9,000. capital profit and pay whatever taxes the government called for thereon. Otherwise, I suggested that it abandon its loan charge against me and report a deposit asset in lieu thereof, or also report a deficit in its deposit assets so as to show its true financial standing as required by the various laws governing its operations.

It is because of the foregoing that I submit that the government of the day may beneficially use this proposed costless method of repaying its bank borrowings without any cost to itself or the public whatsoever, in just the same way that I've done with my bank. In this way, the government may avert such losses in the future, and make capital profits from now on so as to make up for past losses.

I furthermore submit that the government could issue $18 billions in new government money forthwith and deposit it in the banks in exchange for bank balances, but doing this wouldn't free it from its obligation to collect in the $18 billions it is entitled to get free of cost from the banks to settle up and properly balance its banking transactions to date. Hence, all that is necessary now is for the government to take advantage of some one or other of the alternative methods I've submitted to remedy the intolerable conditions I've exposed, and to avert similar losses in the future so as to recoup the losses we've suffered from the lack of sufficient money to conduct our business affairs and pay our public and private debts.

This Formula is issued by:

(FRANK O'HEARN)

Director
The Office of Valuation and Exchange
(a Private Research Bureau)

59 Bethune Blvd.,
Scarboro, Ont.,
Canada.

AM 7-6054

P.S.
See P.S. attached.

P. S. TO EXHIBIT NO. 1

THE FRANK O'HEARN FORMULA

With reference to my charge that half of our past year's revenue deposits has vanished, here's one way of explaining this phenomenon;

Half of the past year's gross revenue deposits were turned over by the depositors to the banks to pay off their borrowings for the year. In this way, the banks got $18 billions of their customers revenue deposits, and they got this earned revenue in addition to the reduction they also got in their liabilities to depositors resulting from the loan repayments.

Unfortunately however, the banks have so far failed to report the revenue deposits they got from their customers as banking assets, received by them in place of the paid-off loan assets. In this way, the banks under-stated their assets to a combined total of $18 billions. This is clear, for had they fully reported their deposit assets, their total assets would now be $18 billions more than they report in their statements, and this in turn would disclose that the true assets of the banks exceed their liabilities to depositors by an equivalent total of $18 billions.

As stated, the banks don't report this extra banking capital, neither do they report the deficit in their deposit assets, and their statements consequently, don't show their true financial condition, as called for by the various Acts governing their operations.

The validity of the foregoing charge is supported by examination of the financial statements issued by the government and the methods employed by it in its banking transactions. My charges are further supported by examination of the banking statements in relation to the Canadian Economy in general.

It was in order to have our missing revenue deposits replaced and recovered that I developed THE FRANK O'HEARN FORMULA to improve current taxing, banking and monetary procedures, all as submitted in this Brief.

Frank O'Hearn

EXHIBIT NO. 2.

O'HEARN'S FORMULA FOR INTERNATIONAL MONEY

PURPOSES:

The purpose of this Formula is to make international dollars available for international trade and settlements, in order to facilitate world trade and exchange, and make all forms of wealth available to all peoples at proper domestic prices, as stated in terms of international money.

The proposed new international money for world trade is the logical outcome and development of existing monetary media and procedures now generally in use for business purposes. The proposed new international dollars and new exchange facilities are based on the findings and disclosures made by Mr. Frank O'Hearn, Scarboro, Ontario, Canada, after many years of extensive and expensive investigation of existing financial methods.

No international money has heretofore been available for international trade, so that the proposed new international dollars are an improvement upon and basically different to anything heretofore available to importers and exporters. When this new money is in general use, all payments and settlements of international trade will be made in international dollars, and not in domestic currencies or other media as heretofore. Payments will be made by cheque drawn by the importer against his checking balance carried on the books of the proposed International Money Office. All such cheques would be certified and charged against the Importer's account in the usual banking manner, and the proceeds credited to the Exporter's account, thus keeping the money balances always in balance, and available for spending by the current holders. Thus, it is intended that an International Money Office be authorized to give effect to the proposals of this Formula.

ASSETS:

The assets of the proposed International Money Office, against which its international money balances are to be issued, would consist of a permanent money account plus various domestic currencies. Unlike ordinary commercial banks, no loans or loan collateral would be carried as assets - only international money balances and domestic currencies.

Deposits of domestic currencies would be accepted by the International Money Office in exchange for international checking account balances. Investment in domestic currencies would be made by the issue of international dollar balances in exchange on the proper exchange basis as calculated for exchange rates and valuations.

As domestic currencies are accepted on deposit in exchange for international dollar checking balances, the International Money Office to acquire its additional assets, could issue cashiers certified cheques in favor of the governments making use of its money and facilities for import and export trade. These certified cheques, when endorsed by the governments concerned, could be held as collateral to the proposed permanent money account by the International Money Office. As this would provide entirely new issues of international money, a clear gain would accrue therefrom.

CAPITAL INCREMENT:

It is intended that the capital gain accruing from the new issues of the International Money Office shall accrue to the governments endorsing its cashiers cheques and the use thereof as collateral to its permanent money account. Thus, by listing this new international money in its cash records and by turning the profits therefrom over to the governments concerned, no debt of any kind would be incurred and no repayments or interest would be called for on the part of the governments reaping the profits. As its money assets are set up, the International Money Office would enter corresponding amounts of international checking balances in the accounts of its customers. The amounts would be entered as these initial cash transactions are effected in international money, less reservations for surplus account, but no additional premiums or discounts would apply. Hence, the governments accepting such proposals would be furnished with an immediate supply of international money available for spending forthwith in international trade.

The amount of bonuses to the participating governments would be calculated on its foreign trade requirements as agreed by the governments and International Money Office, and would bear in general principle, a comparative ratio to the bonuses to other governments to avoid discrimination.

MONEY SUPPLY:

The total supply of international money would be governed by international exchange requirements, and would be controlled by the amount of its own bonus issues plus the amounts put out against investments or deposits in domestic currencies.

DEPOSITS:

As participating governments sell or deposit their own currency at quoted rates with the International Money Office, they would also get their respecti amounts of bonus checking balances. No shortage of international money could result from this arrangement. In this manner the International Money Office would be assured that its assets would always be made up of equivalent parts of permanent money balances and domestic currencies. Unrequired holdings of international dollars by any government could be resold at any time to the International Money Office and its own currency regained. Should it be deemed advisable at any time, an issue of international notes or coinage could be made by the International Money Office for payment of withdrawals from customers checking accounts, but transfers of balances by means of cheques would probably suffice.

EVALUATION:

To ensure the value and stability of its assets and of its outstanding international dollars, the national currencies purchased or accepted for deposit by the International Money Office would have to stand up to certain requirements, otherwise the backing and value of its international money would be prejudiced.

and their expressed valuation in terms of international money would be made use of. In brief, this method would be to ascertain the respective domestic values of the various currencies in terms of a group of selected domestic cost items. A weighted index average thereof would be computed to express the current domestic value of such currency as indicated by its own domestic price values. Such indices and arithmetical computations would then be used to arrive at the proper ratios between domestic currencies and international dollars. A numerical index based on a chosen suitable ratio, would be computed to indicate the proper relation of each domestic currency to the basic ratio. The result would be a comparative rate of exchange and currency valuation suitable for use to govern the amount of international money to be issued in exchange for domestic currencies. In this manner the value of the currencies to be held as assets by the International Money Office would be assured, and the values of its outstanding dollar balances stabilized and their proper exchange values indicated.

To further protect the exchange rates and values of its outstanding international money and of its currency assets, certain other requirements would be made on domestic currencies. Governments concerned would be expected to offer evidence that its domestic economy is in a solvent condition, and that sufficient domestic funds are available to its residents for their domestic requirements. No inflations or deflations of its domestic currency could be permitted to upset the worth of the domestic currencies carried as assets by the International Money Office, otherwise, their currencies would not be acceptable as such assets. Certain maximum and minimum limits to the totals of domestic currencies outstanding at any one time, based on domestic requirements, would be mutually agreed upon.

SUMMING UP:

The foregoing outlines the general make up and procedure of the proposed International Money Office and of its new international dollars. The purpose, restated, of making its money and facilities available for international trade is obviously to facilitate world trade and exchange, and to make all forms of wealth available to all peoples at proper domestic prices, stated in terms of this international money. General use of this new international money would obviate direct dealings in domestic currencies between nations. No reserves of any particular currency would have to be built up by any nation. International Money would remove all artificial restrictions to world trade - no further depressions in world trade would occur and all the evil results of such depressions would be removed once and forever.

Issued and evaluated in the foregoing manner, valuable convertible and negotiable international money would be a perfected medium for world trade. Easier sale abroad for domestic products would be permitted and encouraged. The prices of world trade would express its proper comparative values. Countless benefits would accrue to the entire world - the resulting financial freedom would ensure economic freedom to the entire human race. Prosperity and peace would be made possible by the general use of the funds and facilities of the proposed International Money Office. No other plan is feasible.

As to the financing of the International Money Office itself, this is a comparatively simple matter. Once a government adopts the foregoing proposals and gets its checking account opened, the International Money Office would make a small service charge for handling such account. This service charge would be paid by the government concerned in its own currency. The domestic funds thus received would be spent by the Office on Headquarters expenses and obligations, and for opening, equipping and staffing suitable branch offices in the nations concerned to service their international money accounts.

Each government taking advantage of these proposals and facilities would have the privilege of nominating a member of the Executive or Governing Board of the International Money Office. It would also have the privilege of nominating the Director who would be resident in charge of the branch office in their respective countries.

At the start, the prices to be charged for goods exported would be set by the exporters and would have to be acceptable to the importers to effect a transaction. When the International Money Office operations are in full swing, calculations of the proper exchange rates and values would be made for world trade in accord with the foregoing methods and procedures. These international exchange rates and values and the international dollars would be made available to all nations on the foregoing basis as a sound basis for world trade, exchange and settlements.

Importers and exporters as well as governments would be entitled to take advantage of this perfected international money and facilities to transact world trade; to help prevent repetitions of past depressions; to ensure world prosperity and peace, and as a means of escape from the evils we've all experienced because of the lack of sound international money for world trade.

FRANK O'HEARN
Director
The Office of Valuation & Exchange
(A private Research Institute)

59 Bethune Blvd.,
Scarboro, Ont.,Canada.

NOTE:

See P.S. attached

P.S. TO EXHIBIT NO. 2.

O'HEARN'S FORMULA FOR INTERNATIONAL MONEY

In order to demonstrate how my Formula for international money could be beneficially implemented through existing international agencies, I submitted a proposition to the International Monetary Fund for consideration as follows;

The holdings of the IMF include $8\frac{1}{2}$ billions worth of securities payable in Members currencies. While these are demand securities, they are non-negotiable and non-interest bearing, and while they are held by the Fund as assets, they may be considered as frozen capital derived from subscriptions of the member governments.

The proposal I made to the Fund is intended to bring about the release of this frozen capital by freeing it and making it available to the member nations in the form of negotiable checking balances suitable for use as payments for international trade and balances. By releasing this frozen capital for circulation as international money, the operations of the IMF and the World Bank would be re-vamped and brought into line with the requirements of my Formula.

Checking balances would be allotted to the member nations in lieu of and in place of their frozen share capital. The member nations could then use certified payments drawn on their checking accounts, as valuable negotiable international money in full settlements, in lieu of and in place of existing methods and media.

In giving effect to my proposals, the Fund would turn over its $8\frac{1}{2}$ billions of uncashed demand obligations to the re-vamped International Bank in exchange for a like amount of negotiable checking balances. The IMF would then have the checking balances as its assets in place of the members demand obligations, and it could then commence making payments by way of cheques immediately.

In addition to the foregoing, the re-vamped International Bank would accept all IMF cheques from the Payees as cash deposits, and could do this free of cost to the Fund, and without making any charges or reductions in its checking balances whatsoever. In this way, the IMF would make a clear capital gain for the full amount of the checking issues accepted by the International Bank as cash deposits from the Payees.

Moreover, as the IMF cheques were received on deposit by the International Bank, the Fund could if so desired, draw back an equivalent amount of its present investment holdings against its own checking balances. In this manner, the IMF could regulate the total amount of checking balances outstanding on the books of the International Bank, over and above the permanent portion outstanding against the permanent deposit assets referred to above.

If these proposals were to be carried out as I've suggested, Canada's share of the resulting capital gain would amount to over $300 millions.

P.S. TO EXHIBIT NO. 2.

Though the IMF officials haven't yet advised me of their decision in regard to my proposals, and though my proposals haven't so far as I know, been yet submitted to the member nations for consideration, I can advise the Commission that the United Nations Secretariat for Economic and Social Affairs wrote me saying that my Formula is conceptually well-founded, and that my proposals represent a valuable contribution to the general progress of ideas, and to a better understanding of the fundamental issues which confront the world economy.

It's obvious that a sound international dollar for our foreign trade and settlements is a must if we Canadians are to have a sound basis for peaceful and prosperous international trade and intercourse.

I therefor hope that the Commission will come to the conclusion and will also recommend that Canada should spearhead a movement in the United Nations to have my proposals submitted to the member nations for consideration, and also recommend that Canada should take the necessary steps to get the world at long last an international dollar suitable for our international trade and settlements, all as set out in Exhibit No. 2 hereof.

Frank O'Hearn

The Honourable Dana Porter,
Chairmen, and Members,
Royal Commission on Banking & Finance.

Gentlemen: SUPPLEMENT TO BRIEF FILED BY FRANK O'HEARN

In connection with the brief I filed with you on October 24th last, I deem it necessary for your information to now submit the following as a Supplement thereto:

In my covering letter, I made the charge that half of our past year's revenue has vanished; that our national money supply is short in the total of $18 billions, equivalent to a loss of $1,000. per capita.

I now submit that a major cause of this shortage in our cash resources may properly be laid to the crooked bookkeeping of our banks and government. In support of this serious charge, I submit the following information for your consideration:

RE CROOKED BOOKKEEPING BY OUR BANKS:

My charge in this regard is that the banks took a total of $18 billions from their customers bank accounts in the past year without compensating them in any way whatsoever. They took this money from the government and other customers bank accounts alike, including my own personal accounts. Moreover, they did so without reporting the money as a banking asset, and without reporting the capital gains which accrued to them from their forcible reduction in their liabilities to customers. They did this too, without paying any taxes whatsoever on their ill-gotten gains.

In order to illustrate just how this was accomplished, and at the same time bring you Commissioners up to date regarding my dispute with my bankers, the Bank of Nova Scotia about my own personal accounts as set forth on page 3 of my Brief, I would advise as follows;

On October 31st last, the date of the annual report and statement of assets and liabilities put out by the Scotia Bank, that bank owed me a total of over $13,000. all as shown in my pass books, while at that same date, I wasn't indebted to it in any way whatsoever. Our contra accounts were in proper balance at that date.

While the bank's liability to me was included in its financial statement, it improperly included amongst its assets a loan charge and debt against me for $9,000. despite the fact that I had discharged its alleged debt in September last, and despite the fact that I wasn't indebted to it after that date in any way whatsoever.

Hence, I charge that the Scotia Bank deliberately falsified its financial report and that it should have reported a cash deficit or overdraft in its report instead of mis-reporting that I owed it $9,000. For a period of 40 days last year my bank accounts were properly reported, and my money supply was properly reported too, for the first time in our history.

Despite these facts, the bank on November 8th last forcibly took $9,000 from my savings account by way of an invalid debit, despite my protests, and it did so without compensating me for it in any way whatsoever.

This explains just how the Scotia Bank cheated me out of $9,000. and cut my money supply, and the national money supply too, accordingly. It shows too just how the bank concealed the shortage in its own cash holdings, and how it improperly wrote-off its own deficit at my expense, and extorted $9,000. from me under false pretenses, and caused me a like deficit in my own personal cash resources. This is the common practice of the banks in connection with their customers borrowings, deposits and loan

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I advised the Government about this banking fraud and it advised me that I would have to fix up my accounts with the Scotia Bank myself. This leaves it up to me to take legal action against my bankers, which the Commissioners can quite well understand, is an almost hopeless task. This is particularly so as the Auditors and Lawyers, the Courts and the Press all seem to be quite determined to perpetuate this intolerable condition and thus prevent me from getting my money and banking profits. Of course, they are all acting against the public interest in this matter and are exposing themselves and everybody else to the evil consequences now menacing us all from our own misdeeds.

RE CROOKED BOOKKEEPING BY OUR GOVERNMENT:

My charge hereinregard is that the Finance Department grossly misrepresents the true financial condition of the Government of Canada in its published financial statements. For instance; its statements report a net debt owing by it of over $12 billions. It reports that this unsecured debt is made up of an accumulation of annual deficits.

My investigations however, shows that the net debt it reports is nothing more or less than a deferrment of taxation which the government has so far failed to levy, but which it may properly levy at any time to enable it to meet its unpaid war debts and other bonded debts. Hence from this viewpoint, the government could correct its reports to show an item on the asset side of its statement for Deferred Taxation amounting to $12 billions, in place of the net indebtedness now shown by it.

From another viewpoint however, my Formula discloses that there is a tangible cash asset available to the government which it has so far refused to report or encash. This consists of the amounts owing to it by its bankers to refund the amounts they took from its bank accounts without compensating it in any way whatsoever.

The loss of this money and the government's gross mis-reporting of it, is the direct result of its crooked bookkeeping. It makes a practice of mis-crediting its bankers for loan debts which it previously repaid. In brief, the government is continually turning bond money and tax money over to its bankers without getting any compensation whatsoever from them in return. In this way, the Government is directly responsible for the loss of $18 billions of the people's hard-earned money, and its failure to safeguard and account for these public funds is concealed from the public by its own crooked bookkeeping and falsified financial reports and statements.

From this viewpoint therefor, the government should report the $18 billions owing to it by its bankers, as a cash asset and should collect the money from the banks in the public interest. When the Government does this, its accounts will then show a cash capital surplus of $6 billions, instead of the cash deficits it now wrongfully reports. This Formula opens up a new source of revenue for the Government, apart from and in addition to taxation and borrowings. With our proper money supply available, the need for bank credit would ease off accordingly and interest rates would also ease accordingly and find an economic rate for the general good.

MY FORMULA TO DETERMINE OUR PRESENT MONEY SUPPLY:

My Formula offers a simple yardstick to determine what the total amount of our national money supply should be at the present time. As our national revenue from our gross national product totalled some $36 billions in the past year, and as less than $2 billions of this money still remains in the pockets of the general public, it's clear that the balance of $34 billions was duly deposited in the banks. All this money reached the banks in the form of cash deposits and loan repayments, so that the banks are still responsible for it all. After allowing $16 billions to account for their investment holdings, it's obvious that our deposits and loan repayments for the year provided the banks with a money supply of $18 billions.

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direct result of its crooked bookkeeping. It makes a practice of over-crediting its
for loan debts which it previously repaid. In brief, the government is continually
bond money and tax money over to its bankers without getting any compensation w
ever from them in return. In this way, the Government is directly responsible for
loss of $16 billions of the people's hard-earned money, and its failure to adequate
account for these public funds is concealed from the public by its own crooked boo
ing and falsified financial reports and statements.

From this viewpoint therefore, the government should report the $16 bil
owing to it by its bankers, as a cash asset and should collect the money from the b
in the public interest. When the Government does this, its accounts will then show
cash capital surplus of $6 billions, instead of the cash deficits it now wrongfully re
This Formula opens up a new source of revenue for the Government, apart from an
addition to taxation and borrowings. With our proper money supply available, the
for bank credit would ease off accordingly and interest rates would also ease accor
and find an economic rate for the general good

MY FORMULA TO DETERMINE OUR PRESENT MONEY SUPPLY.

My Formula offers a simple yardstick to determine what the total amou
our national money supply should be at the present time. As our national revenue
our gross national product totalled some $36 billions in the past year, and as few
$2 billions of this money still remains in the pockets of the general public, it is c
that the balance of $34 billions was duly deposited in the banks. All this money re
the banks in the form of cash deposits and loan repayments, so that the banks are
responsible for it all. After allowing $16 billions to account for their investment
ings, it is obvious that our deposits and loan repayments for the year provides the
with a money supply of $18 billions.

According to my Formula, this supply of money constitutes a national and banking monetary asset, and I therefor call upon the banks in the public interest to list this money supply in their statements as an asset, and to also list this amount of additional liabilities as owing to the customers from whom the money was taken without giving them offsetting compensation in return.

As the banks however, devalued their own monetary asset, they could alternately, report a cash deficit or cash overdraft on the asset side of their statements to offset their hidden profits or liabilities, instead of discarding their own assets to conceal their hidden liabilities or profits.

Hence, my Formula states that at the present time our national money supply should total $18 billions more than the amounts reported by the governments and banks. This enlarged amount is equivalent to the gross amount of our national revenue after allowing for the amount of currency outstanding in the hands of the public and the amount of bank investment holdings. This is why I call for this national money supply to be listed by the banks as monetary assets, and this is why I call for the banks to issue credits thereagainst in favor of the government. This would enable the government to write off its deficits and provide for the payment of the public debt on maturity.

If this Formula were to be taken advantage of by the Government of the day, its socalled deficits or net debt would be replaced with bank balances, and would provide it with a $6 billion cash surplus. Our banking assets would then total $18 billions more than they do now and would thus provide the banks with sufficient assets to offset the corresponding increase in their deposit liabilities. This would put both the government and the banks in a sound and solvent condition. It would also provide the government and people of Canada with the additional capital they now so sorely need for their debt and operating requirements, and best of all it would provide this additional capital without further cost and without any increase in the public debt or taxation.

I beg to report that I have already advise the Government of my objection to its appointment of Mr. J. Douglas Gibson, the General Manager of the Bank of Nova Scotia, as a Commissioner to sit on the Commission because of my dispute with his bank and because of the part he has played thereinregard. I strongly protest his sitting in judgement on our dispute, and I object to giving him the opportunity to attempt to brain-wash the other Commissioners in regard to my dispute with his bank, and the other matters set forth in my Brief.

This Submission is intended as a Supplement to my Brief of October 24th last, and is intended to form a part thereof and to be read accordingly.

My thanks go to you Commissioners in anticipation of a sincere consideration of my Brief and Supplement, and I look forward to a personal hearing thereon in due course to support my charges and findings.

In the meanwhile, I remain,

Sincerely,

(Frank O'Hearn)

59 Bethune Blvd.,
Scarboro, Ont.

AM 7-6054

SUBMISSION

to the

R O Y A L   C O M M I S S I O N

O N

B A N K I N G   A N D   F I N A N C E

*

by the

COMMUNIST PARTY OF CANADA

*

March 12, 1962
24 Cecil Street,
Toronto 2B, Ontario.

SUBMISSION OF THE COMMUNIST PARTY OF CANADA
to the
ROYAL COMMISSION ON BANKING AND FINANCE

Mr. Chairman and Members of the Commission:

Para. 1 The Commission has been asked to "inquire into and report on the structure and methods of operation of the Canadian financial system, including the banking and monetary system and the institutions and processes involved in the flow of funds through the capital market".

Para. 2 The ramifications of these systems, institutions and operations are complex and varied. They are a hodgepodge of government and private institutions, with the dominant credit and financial institutions completely in private hands. Each private corporation and financial institution pursues a policy which it considers to be most profitable, without regard to the overall national interest.

Para. 3 Because actual credit is under the control of private institutions, capital investments flow into those sectors of the economy which provide the greatest immediate returns. That is one reason why our mineral resources sector of the economy is over developed, while manufacturing industries are underdeveloped.

Para. 4 The money and credit system fundamentally is a function arising from the mode of production - the economic system, and its strength and stability cannot be separated from the economic system. While the direction, regulation and operation of the money and credit system is a direct responsibility of the Federal government, the organization, control and planning of production is not. This contradiction is acknowledged, by implication, in the provision for decennial reviews and appropriate revisions of the Bank Act to bring the banking and financial system into line with the needs and difficulties of production.

Para. 5 This contradiction was recognized also in 1935, when the Federal government was impelled by necessity to take away from the chartered banks the right to issue currancy. But developments in industry, commerce, and finance during this century have been such that if the money and credit system, and the varied institutions through which it operates, are to serve the national interest, their responsibility should cover a very much wider field than is provided by the Bank Act or the Bank of Canada Act.

Para. 6 Financial policy reflects, and in turn affects, every facet of the economic life of Canada. The fact that the financial and banking system is, basically, an expression of production, leads to the conclusion that the primacy of production should be recognized in policy-making; anything that is physically possible in Canada is also financially possible. The purpose of financial policy should be to implement a growth of actual physical production of not less than 5% per year. The Federal Government should be provided with the necessary authority to be able effectively to use financial policy and the financial institutions of the country in order to achieve the objective of economic growth, with full employment.

Para. 7 We wish to bring to your attention the preamble of the Bank of Canada Act.

"<u>An Act to Incorporate the Bank of Canada</u>

Para. 8 WHEREAS it is desirable to establish a central bank in Canada to regulate credit and currency in the best interests of the economic life of the nation, to control and protect the external value of the national monetary unit and to mitigate by its influence fluctuations in the general level of production, trade, prices and employment, so far as may be possible within the scope of monetary action, and generally to promote the economic and financial welfare of the Dominion:

THEREFORE, His Majesty, by and with the advice and consent of the Senate and House of Commons of Canada, enacts as follows:"

Para. 9 If the provisions of the Act were to embody the essence of its preamble, a good beginning would be made to "promote the economic and financial welfare" of Canada.

Para. 10 We emphasise that financial policy can be made fully effective only if the Bank of Canada becomes the head of a unified Canadian banking system, whose operations are integrated with the <u>planned</u>

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development of industry, trade and commerce. The Communist Party of Canada contends that to achieve such a goal, nationalization of major industries (mainly U.S.-owned and -controlled industries) as well as banking and credit, is a prime necessity, for the following reasons:

Para. 11 a) Nationalization of the banking and credit system would make it possible to achieve a balanced economic development, based on the genuine industrialization of Canada - manufacturing of finished goods from our natural resources, our energy and our manpower, and the elimination of the condition in which manufacturing occupies a less important part of the economy than 10 years ago. This would reduce our dependence on the U.S.A. for a large part of our manufactures and for almost all our machinery and machine-tools.

Para. 12 b) Nationalization would make it possible to deal with the problem of uneven economic development particularly in the Maritimes and the Prairie Provinces.

Para. 13 c) Nationalization would help to reduce interest charges on loan capital, encourage capital investment in manufacturing, increase the rate of economic growth and stimulate employment. Lower interest rates would discourage the flow of foreign capital and thus reduce our dependence upon it.

Para. 14 d) Nationalization would ensure a much more efficient credit system.

Para. 15 e) Nationalization would eliminate the present superimposed absolute control by a small group of financiers over the production and distribution of goods.

Para. 16 Without a unified credit system and Federal government control of credit we cannot achieve a balanced economic development and mobilize the capital resources of Canada.

Para. 17 The control of credit by private institutions tends to increase the interest charges on loan capital and thus discourages capital investments in those sectors of the economy which are most urgently needed in the national interest. High interest rates attract foreign capital and so increase our dependence.

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Para. 18 The present mixture of private and public credit institutions is the most inefficient system. It superimposes on the process of production an absolute control by a small group of private financial institutions.

Para. 19 While the absence of a co-ordinated system of financial credit hampers the growth of our economy, it is by no means the only factor responsible. The fatalistic concept of the inevitability of war has resulted in military expenditures of about $20 billion since the end of World War 2. This is one-third more than the capital investment from all foreign countries since the war. This policy has distorted our economy, resulting in the over-production of raw materials (uranium, lead, zinc, copper and the neglect of our manufacturing industries. This enormous expenditure was not only socially wasted, but if only a part of it had been invested in the Canadian economy it would have brought the most beneficial results to the Canadian people.

Para. 20 The most important reason, however, for the stagnation and distortion of our economy is the alarming growth of the control and domination of the major sectors of our economy by U.S. monopolies.

Para. 21 In the manufacturing industries (which are technically dependent on the U.S. parent industries and are in effect branch plants) control of U.S. residents increased from 39% in 1948 to 44% in 1958 and these in the main are the dominating monopoly industries; in petroleum and natural gas in 1958 there was 69% U.S. control, while in mining and smelting this control increased from 37 to 55 per cent. By 1959 of the 20.7 million long term foreign investments in Canada 75% was U.S. investment.

Ever since 1949, when the plan for the integration of the Canadian and U.S. economies (Abbott Plan) was introduced by the Liberal Government, the Communist Party has warned that the long-term effect of this would be a growing disproportion in the Canadian economy, rising unemployment and greater loss of our sovereignty.

Para. 22 The basis of this policy of "integration", acceded to now

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by Canadian governments for 14 years, was the assumption of the inevitability of war and the necessity for raw material development in Canada as a basis for the war industry of the U.S.

Para. 23 In 1952 President Eisenhower made clear U.S. policy as follows:

Para. 24 "From my viewpoint, foreign policy is, or should be, based primarily on one consideration. That consideration is the need for the United States to obtain certain raw materials to sustain its economy, and, where possible, to preserve profitable foreign markets for our surpluses." In the same year the Paley Report, which was a detailed study of the raw materials of the world in the light of U.S. needs declared that of 22 strategic materials, 10 were present in Canada.

Para. 25 In our brief to the Royal Commission on Canada's Economic Prospects in January, 1956, we stated:

Para. 26 "Our industrial development has not included that emphasis upon the production of the machinery of production - machine-tools, modern labor-saving machines, and a steel industry which takes care of Canadian needs, which constitute the very heart of an independent national economy. On the contrary, U.S. ownership and control of Canadian industry has reduced large sections of it to a parasitic existence in the sense that they are almost wholly dependent for their vital parts upon U.S. imports. Our industry, because of foreign control, is poorly developed in the basic dynamic sense of being able to produce its own means of production, and is dependent upon the U.S.A."

Para. 27 Developments since that time have only emphasized the same trend. In October, 1960, for example, Mr. James Coyne, then governor of the Bank of Canada, said in Calgary:

Para. 28 " 'No other nation so highly industrialized as Canada has such a large proportion of its industry controlled by non-resident companies,' to quote the restrained language of a Dominion Bureau of Statistics publication. I prefer to put understatement behind us and suggest that no country in the world with anything like our relative state of development has ever had such a degree of foreign domination, or even half or one-quarter the degree of foreign domination.

Para. 29 "By far the lion's share of the foreign control rests with American companies, the growing predominance of which has been a marked feature of our postwar history.

Para. 30 "Most Canadians would agree that the degree of foreign domination, and especially American domination of Canadian economic life has increased, is increasing, and ought to be diminished."

Para. 31 To end the imbalance in the economy to ensure the all-round development of Canada for its people, we would remind the commission of another speech by Mr. James Coyne in Toronto (November, 1960) in which he stated that a growth of population and employment would require,

Para. 32 "a strong and active policy in the economic sphere on the part of all levels of government. The operation of natural forces along the 'policy of laissez-faire' will not cure our troubles. The lead in such matters will naturally come from the national government."

Para. 33 All of these factors taken together - private control of money and credit, the fatalistic concept of the inevitability of war, U.S. control and domination of the major sectors of our economy - call for far-reaching measures. It is the considered opinion of the Communist Party that the nationalization of the U.S.-owned and -controlled industries in Canada and the nationalization of the credit system are the solutions to the problem of economic growth in Canada.

Para. 34 The functions of the various forms of activity through which the process of mobilizing, concentrating, and distributing the financial resources of the country operates, are related so intimately that nationalization of banking and credit requires nationalization of the Chartered Banks, trust companies and insurance companies, and their operation as a public service under governmental direction and control, in co-ordination with the government's policy on taxation and investment, all with the aim of expanding the economy, redistributing the national income by social welfare measures and managing the national debt.

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Policies Leading Towards Effective National Coordination and Control of Canada's Financial Structure, in the Public Interest.

Para. 35 To say the levelling down of financial impediments to full employment and the increasing welfare of the Canadian people will be achieved only with full nationalization of the financial institutions, is not to deny that substantial improvements can come from an extension of public control and more effective public financial operations short of nationalization. We strongly support interim measures which will enhance the welfare of workers and their families in this as in other spheres of economic life. In fact, this is the touchstone for judging government policies -- do they contribute to the welfare of the majority of the people, or do they not?

Para. 36 It is from this point of view that we submit the various proposals which follow. Each one, we believe, will bring an improvement to the existing situation. Taken together, they should accelerate movement along the road towards better living standards and more social security for the Canadian people.

1. National Investment for Economic Expansion

Para. 37 The importance of national investment in stimulating economic activity is illustrated in the table below. (This table is based on figures from appendix A).

Para. 38 Investment is taken as the sum of expenditures on housing, government capital (excepting military), business fixed capital and inventory changes (from the D.B.S. "National Accounts").

Para. 39 Economic activity is measured by the D.B.S. Index of Industrial Production, the periods of contraction being those in Prof. Hood's report to the recent Senate Committee on Manpower.

Para. 40 The table shows that in the period immediately following declines in total investment, the economy slipped back generally.

Decline in Investment	Contraction in Economic Activity
1948	Oct. '48 - Sept. '49
1952	
1954	May. '53 - June '54

(table continued)

Decline in Investment	Contraction in Economic Activity
1957 1958	April '57 - April '58
1960	May '60 - March '61

Para. 41 In order to sustain a rising standard of life and even the minimum of desirable opportunity for our sons and daughters, Canadians must insist upon governmental responsibility for maintaining the rate of investment at least a little higher than the rate of the growth of population. The characteristic post-war ups and downs of investment in Canada must be smoothed out. This can be done and financial policy should be directed to insuring it.

Para. 42 The aim of financial policy should be to see that the savings of the people are invested in the dynamic development of the country: its productive, transport and communication facilities, its domestic trade and foreign commerce, its stock of social facilities. It is a matter of grave concern to all Canadians that, in the absence of such a conscious policy, the production of goods in our country has not kept pace with the growth of population during recent years.

Para. 43 Indeed, the per-capita production of goods has actually declined, so that in 1960 it was $54 per person less than in 1956.

Para. 44 This whole field of investment is so important to the welfare of all Canadians that we recommend the establishment of a Department of National Investment under a senior cabinet minister. This department might well combine the most of the present functions of the Department of Northern Affairs and National Resources and the Department of Public Works. The new Department of National Investment would then include such additional functions as--

(a) long term investment planning to determine the needed scope, timing and location of public investment.

(b) public investment in housing (expanded Central Mortgage and Housing Corporation)

(c) public investment in resource and regional development projects (e.g. national power grid; hydro power on Columbia River in B.C., Hamilton River in Labrador;

uranium enrichment at remote power site; Chignecto Canal in New Brunswick, etc.)

(d) public investment in new manufacturing where private investment fails to go (e.g. coal-based chemical industry in Maritimes; industrial components, like transistors, tightly controlled by foreign parent companies; steel industries (basic and fabricating) near ore sites); possibly the Industrial Development Bank should be put under this department.

(e) public investment in social facilities (expanded public works, hospitals, schools, highways, roads, etc.)

Para. 45 The financing of such projects could be done by the sale of government bonds for miscellaneous small projects, and of bonds guaranteed by the government covering specific large projects (like the C.N.R.). Especially for self-liquidating projects like power developments, new manufacturing facilities, and so forth, the latter method should be used and the bonds gradually retired out of earnings.

Para. 46 Where such projects are individually administered by Crown Companies or Commissions, the limits of authority and responsibility must be clearly defined so that the resources of such corporations, including any profits, be clearly specified as publicly-owned property and used solely for the public good.

Para. 47 Crown Companies should not invest their surplus funds in foreign countries (like Polymer Corp. is reported to be doing in Belgium). Crown Corporations are the property of the Canadian people. Regardless of the motives which led to their establishment, accumulated profits are not the private affair of their appointed directors or of the cabinet minister on whose recommendation they were appointed. Such profits should be paid to the Receiver-General of Canada. To invest them in foreign countries, while Canada is in urgent need of investment capital, is a practice to be condemned and made impossible in the future, by law.

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Para. 48 As a further step to insure a national investment policy in the public interest there must be some public control over capital exports and the general direction of private capital investment in Canada.

Para. 49 First, since the major portion of funds administered by the financial institutions (banks, trust companies, insurance companies, pension trusts, etc.) are the savings of the community entrusted to them, at least 50 per cent of their assets should be required to be in the form of Dominion of Canada bonds. This will automatically assure a steady market for government bonds and provide substantial funds for carrying out public investment policies. It will also guarantee that at least half of the nation's savings are invested in worthwhile projects for the development of Canada.

Para. 50 Second, the federal government should have veto power over any large private investment (say over some specified amount, such as $100 million) considered not to be in the public interest A government trying to protect the welfare of the people, for example, would not have allowed the unwarranted over-expansion of uranium mining, with its subsequent inevitable collapse and its attendant hardships for the people and communities directly involved.

Para. 51 Third, export of capital from Canada for long-term investment abroad <u>should be subject to government licence granted solely on the basis of what is in the best interests of the Canadian people. This could effectively put a stop to the draining of needed capital out of Canada for investment abroad</u> in enterprises exploiting other people to the detriment of the good name of Canada internationally.

2. <u>Expansion of Purchasing Power in Stable Dollars</u>

It is our contention, and the main thesis of this Statement, that national policy in respect to regulation of the money and credit system and the institutions that are involved in its operation, should be directed to maintain the purchasing power of the Canadian dollar at a stable level, while making available all the credit required for continuous expansion of the country's economy. This is matter of direct personal concern to the overwhelming majority of Canadians.

Para. 52 We do not assert that financial policy <u>alone</u> will insure continuous expansion of the national economy and a stable price

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level, particularly in the long term; but we do consider that a central test of whether or not financial policy is aimed primarily to serve the real interests of the people is its influence upon the internal purchasing power of the nation's currency. The record is a sorry indictment of successive federal governments' financial policies:

In 25 years since 1936, the dollar fell to 47¢ of its former value.

In 16 years since 1945, the dollar fell to 58¢ of its former value.

In 10 years since 1951, the dollar fell to 88¢ of its former value.

In 5 years since 1956, the dollar fell to 91¢ of its former value.

Para. 53 This has obviously had drastic effects upon the lives of millions of Canadians who could least afford it.

Para. 54 There is much that the government can do to bring about price stability -- maintenance of the real purchasing power of the dollar -- short of direct price control, as in wartime. For example, the government can:

(a) stop expanding the currency faster than production (there are better ways of financing public investment than this, as we have recommended in the previous section)
(b) cut unproductive military spending
(c) hold down interest rates, instead of giving a lead to raising them, as in the 1958 bond conversion campaign. (In fact, this is a key element of financial policy, affecting many other facets of the economy. The high interest rates of recent years have added to the prices of all goods, stimulated additional unwanted foreign capital inflow and increased the burden of debt charges on this and future generations.)

Para. 55 Inseparable from protecting the people by maintaining a stable price level, is the need to protect them against usury. It is a shocking thing that at the present time the law permits money-lenders to collect as much as 24 per cent per annum

level, particularly in the long term; but we do consider that a central test of whether or not financial policy is aimed primarily to serve the real interests of the people is its influence upon the internal purchasing power of the nation's currency. The record is a sorry indictment of successive federal governments' financial policies:

In 25 years since 1936, the dollar fell to 47¢ of its former value.

In 16 years since 1945, the dollar fell to 58¢ of its former value.

In 10 years since 195[illegible], the dollar fell to 88¢ of its former value.

In 5 years since 1956, the dollar fell to 91¢ of its former

Para. 53 This has obviously had drastic effects upon the lives of millions of Canadians who could least afford it.

There is much that the government can do to bring about

Para. 54 price stability -- maintenance of the _real_ purchasing power of the dollar -- short of direct price control, as in wartime. For example, the government can:

(a) stop expanding the currency faster than production (there are better ways of financing public investment than this, as we have recommended in the previous se

(b) cut unproductive military spending

(c) hold down interest rates, instead of giving a lead to raising them, as in the 1958 conversion campaign. (In fact, this is a key element of fiscal policy, affecting many other facets of the economy. The high interest rates of recent years have added to the price of all goods, stimulated additional unwanted foreign capital inflow and increased the burden of debt that on this and future generations.)

Para. 55 Inseparable from protecting the people by maintaining a stable price level, is the need to protect them against It is a shocking thing that at the present time the law permits money-lenders to collect as much as 24 per cent per annum

on small loans. This must be stopped. Seven per cent should be the maximum amount of interest and financial charges in any one year and legislation should be enacted to make this limit effective.

Para. 56 Besides holding the dollar stable and curbing usury, we need to expand aggregate purchasing power to ensure a rising standard of living for a steadily increasing population. Eighty per cent of consumer expenditures are regularly based on the wages and salaries distributed. The first source of increased effective purchasing power, therefore, is to be found in an expanding wage fund. This can result only from increased and/or increased wages. The focal points for government action here are:

(a) expanded employment in the investment sector
(b) expanded employment in consumer goods industries, arising from expanded purchasing power
(c) a realistic, country-wide, minimum wage law of $1.25, to strengthen the floor under wage rates.

Para. 57 Social security is the other important field for government measures to assure steadily expanding consumer purchases. More adequate standards are badly needed in several social security measures, but especially in old-age pensions. These are still scandalously low, and it is precisely the old-age pensioners who have been hardest hit by the declining internal value of our dollar.

Para. 58 Where is the money to come from for increased social security and like government expenditures? We submit that there are substantial untapped sources of tax revenue which can provide the necessary funds -- for example, capital gains and windfall profits which are still an untaxed element increasing wealth in the hands of the rich in Canada, and reduced arms expenditures.

3. <u>Assistance to Municipalities in Financing</u>

Para. 59 Canadian municipalities are hard pressed to meet the continually increasing demands for local improvements, education, welfare and other local services. Property taxes is the main

source of municipal funds, and this system places an impossibly heavy burden on small home-owners.

Para. 60 Municipal borrowing has been resorted to on a very large scale in recent years. In the fifteen post-war years 1946-1960, the total municipal debt increased from $868 million to $4,277 - a fourfold increase. Further, nearly $1 billion of the 1960 total were foreign-pay securities as a consequence of the municipalities borrowing heavily in the United States. Not only does continued foreign borrowing pyramid the annual interest total going out of the country, but presumably the principal itself will have to be repaid, someday.

Para. 61 To stop foreign borrowing by Canadian municipalities and to assist them to obtain the cheapest money available in Canada, we recommend the establishment of a federal Municipal Loan Board to assist the municipalities to raise funds in Canada by providing federal government guarantees to approved issues of municipal bonds. The Municipal Loan Board could be organized as a subsidiary of the Bank of Canada, similar to the Industrial Development Bank; or the Board could come directly under the Minister of Finance.

Para. 62 To the extent that municipal bonds were not defaulted, the guarantee would cost the federal government nothing. But it would substantially cheapen the cost of borrowed money to the municipalities -- especially if the federal government energetically promotes low interest rates. This method of federal guarantee has been widely applied in C.M.H.C. housing loans. In this field it has had some effect in protecting small home-owners from exorbitant mortgage interest. Why cannot the same sort of federal assistance be afforded the hard pressed municipalities?

4. <u>Farm Credits</u>

Para. 63 Various elements of federal financial assistance to farmers are now grouped under the Department of Agriculture -- e.g. Farm Credit Corp., Agricultural Stabilization Board, Prairie Farm Assistance Administration. But an important part of the machinery for assisting farms -- the Farm Improvement Loans

Act -- remains under the Department of Finance. We do not see why this Act is not administered by a Board under the Department of Agriculture.

Para. 64 As presently constituted, the Farm Improvement Loans Act merely guarantees the private banks against losses up to a total of 10 per cent on all the loans they make to farmers. The total of all loans that can be insured under the Act at any one time is $300 million. Calls on the federal government to make good on defaulted loans have been negligible, so the Act has operated practically without cost to the government. It is quite obvious, therefore, that the Act does not go nearly far enough in providing financial help to farmers to purchase implements, livestock, or pay for construction and development work. Either the federal guarantee should be raised substantially to encourage the banks to be more lenient in the granting of these loans, or the government should make them directly to the farmers.

5. Facilitating Foreign Trade

Para. 65 Federal responsibility for assisting export trade has already been recognized with the setting up of the Export Credits Insurance Corporation under the Department of Trade and Commerce. The E.C.I.C.'s functions are being expanded somewhat with the provisions for guaranteeing of credits and purchase of foreign obligations up to $300 million. This is all right as far as it goes, but it is not nearly far enough and will not seriously help our worsening trade crisis. The E.C.I.C.'s function is only insurance of loans made by private financial institutions or the exporter himself. It is not intended to extend needed credit to a foreign country wishing to buy in Canada and repay over a period of years.

Para. 66 We recommend that an Export-Import Bank be established, under the Department of Trade and Commerce. Its functions would encompass three important kinds of assistance to Canada's foreign trade.

Para. 67 1. Export Credits: The biggest lack now is for long-term loans (5 to 15 years) to foreign countries wishing to buy capital

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goods in Canada at low interest rates, say 3%. Other exporting countries have such export credit machinery and Canada is closing the door on export trade in machinery, etc. by its lack here. A second element of export credit which the Export-Import Bank should undertake is the holding of foreign currencies, where the importing country cannot pay immediately in "hard" currency. An exporter to India, for example, might be able to sell for rupees but not for Canadian dollars or sterling. In this case the Export-Import Bank would agree beforehand to accept the rupees from the exporters, and pay him in Canadian dollars -- in effect making a loan to India covered by rupees until the latter could be used up.

Para.68 2. Import Credits: This is a side of trade financing not now touched by the Canadian government. But it could open up avenues for expanding our export trade to countries with useful goods to sell and no contracts with Canadian importers. For example, under the Canadian-Soviet trade agreement Canadian exports could be increased in the ratio of 2 to 1 against our increased imports of Soviet goods. A means for directly expanding such import volume could be provided by the Export-Import Bank contracting for bulk purchases from the Soviet trading organizations, arranging for shipment to Canada and selling them to Canadian distributors. Besides locating the goods, the Bank will in effect be extending credit to the distributor until the goods reached him. Such techniques could be applied anywhere new sources of useful goods abroad were discovered with the two-way trade implication of expanding our exports.

Para.69 3. Foreign Exchange Rate: A third element in facilitating foreign trade is the exchange rate. Operation of the exchange fund might possibly be left to the Bank of Canada. But the object should be to maintain the external value of our dollar at the most appropriate level for both sides of our foreign trade and for internal price and employment policies. At best this level is a compromise that should be made consciously by the country concerned -- not by the blind force of external economic pressures.

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General Conclusions.

Para. 70 The division of the social product between present consumption and investment for future benefit, is basic to the welfare of the people of every country. Of course, there are many factors which intervene between this prime cause and ultimate effect, to condition the general level of prosperity and that of particular sectors. But this decision as to the appropriate division of the social product is far too fundamental to be left entirely to chance.

Para. 71 Recognition of this fact is implicit in the now quite common proposals for cyclical budgeting, expanded public works in times of economic depression, etc. In our opinion, such proposals usually touch only the fringes of the problem. We believe that the more the conscious economic planning by central authority in the public interest, made possible by the nationalization of basic industries and the credit system, the better the ultimate results. To this end we propose an important extension of federal government activity in planning, controlling and carrying out national investment. Of course we recognize that the existing economic system places limitations on such activities, but such limits are themselves somewhat elastic and they have certainly not yet been stretched in Canada.

Para. 72 In our opinion, much can be done now, with the existing government agencies to curb monopoly and place it under greater public control.

Leslie Morris
Leslie Morris
General Secretary

Tim Buck
Tim Buck
Chairman
per ZS

March 12, 1962

24 Cecil Street
TORONTO 2-B, Ontario

APPENDIX A.

Year	GNP Million	Capital Invest* Million	C I as % GNP
1946	11850	2121	17.9
1947	13165	2788	21.2
1948	15120	3132	20.7
1949	16343	3588	21.9
1950	18006	4486	24.9
1951	21170	5653	26.7
1952	23995	6003	25.0
1953	25020	6559	26.3
1954	24871	5591	22.5
1955	27132	6555	24.1
1956	30585	9118	29.8
1957	31909	8948	28.0
1958	32867	8031	24.4
1959	34857	8714	25.0
1960	35959	8516	23.7

All figures are from National Accounts

* housing, government capital excluding military business capital and inventory change.

SUMMARY

SUBMISSION OF THE COMMUNIST PARTY OF CANADA

to the

ROYAL COMMISSION ON BANKING AND FINANCE

The money and credit system fundamentally is a function arising from the mode of production - the economic system, and its strength and stability cannot be separated from the economic system. While the direction, regulation and operation of the money and credit system is a direct responsibility of the Federal government, the organization, control and planning of production is not.

The purpose of financial policy should be to implement a growth of actual physical production of not less than 5% per year. The Federal Government should be provided with the necessary authority to be able effectively to use financial policy and the financial institutions of the country in order to achieve the objective of economic growth, with full employment.

The Communist Party of Canada contends that to achieve such a goal, nationalization of major industries (mainly U.S.-owned and -controlled industries) as well as banking and credit, is a prime necessity, for the following reasons:

a) Nationalization of the banking and credit system would make it possible to achieve a balanced economic development.

b) Nationalization would make it possible to deal with the problem of uneven economic development particularly in the Maritimes and the Prairie Provinces.

c) Nationalization would help to reduce interest charges on loan capital, encourage capital investment in manufacturing, increase the rate of economic growth and stimulate employment.

d) Nationalization would ensure a much more efficient credit system.

e) Nationalization would eliminate the present superimposed absolute control by a small group of financiers over the production and distribution of goods.

While the absence of a co-ordinated system of financial credit hampers the growth of our economy, it is by no means the only factor responsible. The fatalistic concept of the inevitability of war has

resulted in military expenditures of about $20 billion since the end of World War 2. This is one-third more than the capital investment from all foreign countries since the war. This policy has distorted our economy, resulting in the over-production of raw materials (uranium, lead, zinc, copper) and the neglect of our manufacturing industries. This enormous expenditure was not only socially wasted, but if only a part of it had been invested in the Canadian economy it would have brought the most beneficial results to the Canadian people.

The most important reason, however, for the stagnation and distortion of our economy is the alarming growth of the control and domination of the major sectors of our economy by U.S. monopolies.

It is the considered opinion of the Communist Party that the nationalization of the U.S.-owned and -controlled industries in Canada and the nationalization of the credit system, are the solutions to the problem of economic growth in Canada.

The functions of the various forms of activity through which the process of mobilizing, concentrating distributing the financial resources of the country operates, are related so intimately that nationalization of banking and credit requires nationalization of Chartered Banks, trust companies and insurance companies, and their operation as a public service under governmental direction and control, in co-ordination with the government's policy on taxation and investment, all with the aim of expanding the economy, redistributing the national income by social welfare measures and managing of the national debt.

We strongly support interim measures which will enhance the welfare of workers and their families, in this as in other spheres of economic life. In fact, this is the touchstone for judging government policies -- do they contribute to the welfare of the majority of the people, or do they not?

In order to sustain a rising standard of life and even the minimum of desirable opportunity for our sons and daughters, Canadians must insist upon governmental responsibility for <u>maintaining</u> the rate of investment at least a little higher than the rate of growth of population. The characteristic postwar ups and downs of investment

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In order to sustain a rising standard of life and even the minimum of desirable opportunity for our sons and daughters, Canadians must insist upon governmental responsibility for maintaining the rate of investment at least a little higher than the rate of growth of population. The characteristic postwar ups and downs of investment

must be smoothed out. This can be done and financial policy should be directed to insuring it.

This whole field of investment is so important to the welfare of all Canadians that we recommend the establishment of a Department of National Investment under a senior cabinet minister.

* * * *

There must be some public control over capital exports and the general direction of private capital investment in Canada. First, since the major portion of funds administered by the financial institutions are the savings of the community entrusted to them, at least 50 per cent of their assets should be required to be in the form of Dominion of Canada bonds. Second, the federal government should have veto power over any large private investment (say over some specified amount, such as $100 million) considered not to be in the public interest. Third, the federal government should prohibit the export of capital from Canada for long-term investment abroad, in enterprises exploiting other people.

* * * *

It is our contention that national policy in respect to regulation of the money and credit system and the institutions that are involved in its operation, should be directed to maintain the purchasing power of the Canadian dollar at a stable level, while making available all the credit required for continuous expansion of the country's economy.

Inseparable from protecting the people by maintaining a stable price level, is the need to protect them against usury. Seven per cent should be the maximum amount of interest and financial charges in any one year and legislation should be enacted to make this limit effective.

We need to expand aggregate purchasing power to ensure a rising standard of living for a steadily increasing population. The first source of increased effective purchasing power, therefore, is to be found in an expanding wage fund. This can result only from increased employment and/or increased wages.

Social security is the other important field for government measures to assure steadily expanding consumer purchases. More adequate standards are badly needed in several social security measures, but especially

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March 12, 1962

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